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PROPOSED EXEMPTION OF RESIDUAL FUEL OIL

FROM THE

MANDATORY PETROLEUM ALLOCATION AND PRICE REGULATIONS

COMPILATION OF STATEMENTS OF WITNESSES BEFORE THE SUBCOMMITTEE ON ENERGY AND POWER APRIL 6, 1976

Compiled by the Staff for the Use of the

SUBCOMMITTEE ON ENERGY AND POWER

OF THE

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

U.S. HOUSE OF REPRESENTATIVES

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of

ZEB D. ALFORD

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from

FEDERAL PRICE AND ALLOCATION CONTROLS

BEFORE

<u>THE SUBCOMMITTEE ON ENERGY AND POWER</u>

of the

<u>INTERSTATE AND FOREIGN COMMERCE COMMITTEE</u>

<u>April 6, 1976</u>

I am Zeb Alford, Manager of Fuels of the New England Electric System. I am appearing on behalf of the New England Electric System Companies. This electric utility, through its retail subsidiaries in Massachusetts, Rhode Island and New Hampshire, provides electric service to approximately 1,000,000 customers. It is the second largest electric utility in New England and burns approximately 20,000,000 barrels of residual fuel oil annually in the generation of electricity. In addition to my representing the New England Electric System companies ("NEES") at today's hearing, I am also speaking on behalf of the New England Council. The New England Council represents over 1,500 industries and businesses throughout New England. The New England Council is concerned with preserving, enhancing and capitalizing on the natural resources of New England. I am the Chairman of the Energy Committee of the New England Council.

We appear today to testify with regard to the proposed amendment exempting residual fuel oil from the Federal Energy Administration's mandatory petroleum allocation and price regulation pursuant to Section 12 of the Emergency Petroleum Allocation Act of 1973 as amended. NEES and the New England Council support the proposed amendment to exempt residual fuel oil from the Federal Energy Administration's allocation and price control regulation. Our testimony will cover reasons why we believe that continued allocation and price control of residual oil are not

in the consumer's interest, as well as to suggest ways to lower costs to consumers.

First, we would like to review briefly the present status of the residual fuel oil market and the recent history of this market in order to put in perspective our later comments and recommendations. In my opinion, the market place--not FEA-- has been regulating the price of residual fuel oil since the early spring of 1974. I believe this can be shown by the fact that the so-called "banked costs" (that is, potential higher costs that could permissibly be passed on to consumers by oil companies) today are approximately $1.5 billion. This large bank of unrecovered cost increases exists because the marketplace has been setting the price on all petroleum products well below what the FEA's price control would permit.

Secondly, it's important to note that the market share of large companies has decreased in the residual oil market. These changing shares are set out in the communication from FEA to the Congress that proposed elimination of residual oil price and allocation controls. To understand the residual fuel oil market it is necessary to understand the central role of the East Coast in that market. The East Coast of the United States uses approximately 65% of all residual oil consumed in the nation. 90% of all residual oil imports to the nation are consumed on the East Coast. Throughout the nation utilities burn approximately 50% of the residual oil consumed in the nation. In addition to these domestic statistics, it is important to remember that America consumes only 20% of the residual oil in the world market. Thus, the market price of residual oil throughout the United States is set by the price paid on the East Coast for imported residual oil. It is important to understand

that regulating the price of crude oil in the U.S. refineries has not reduced the market price of residual oil. This price is determined not by our actions but by the world-wide market value placed on residual oil. At no time over the past two years has domestic residual been cheaper to buy than foreign residual oil. The price has been the same. But this international market price will surely be pressured upward because, as FEA predicts, demand for residual oil world-wide is expected to increase by 9 to 13% per year as the economies of Western Europe and Japan rebound. That is a much larger increase in consumption that we have seen in previous years. This could create problems in the future unless all petroleum products are decontrolled because otherwise price controls for some products will cause demand distortions among products.

Next, I would like to discuss why continued Federal Energy Administration controls are not in the consumer interest. It must be remembered that FEA has never directly regulated the price of residual oil, because, as I discussed earlier, much higher costs than the market price would have been possible under regulation. During the Arab embargo, it is still very clear in my memory that FEA diverted two or three cargoes to NEES that were at very high prices. These cargoes came from the spot market for residual oil. The spot market is the free world market where the marginal barrel of residual oil is priced. This oil comes from refineries all over the world and it sells to the highest bidder. Even if FEA had attempted to regulate the price of residual oil, it is not clear to me how it is possible to regulate a product where the price is set because of world demand and not just U.S. demand. The "Canadian Caper" is another good example of federal good intentions gone astray. Before the mid-East embargo, we had a contract with a Canadian oil company that was supplying

residual oil to NEES. We had all the escalation clauses that are normal with contracts and, in fact, the contract price did escalate from approximately $3.50 a barrel to about $12.00 a barrel over a two or three month period. However, the spot market price at the time was approximately $14.00 or $15.00 per barrel. The Canadian government passed a law that said that petroleum products coming from Canadian refineries would be priced in "the Canadian interest." I went to Canada three times to speak to the Canadian Energy Board to determine what "in the Canadian interest" really means. What it finally turned out to mean was the highest price the spot market would pay. We tried to get FEA to do something about the Canadian pricing policy but we were never successful in having anything done about this obvious ripoff by our next door neighbor.

If the FEA had actually controlled the price of oil products it would have cost the consumer an extra $1.4 billion--that's what has been "banked" because the market price was below what the regulated prices were. There are two major reasons why the market has stayed below the theoretically permitted price: First, the world-wide recession; and second, the conservation that did take place world-wide largely because of the cartel prices. But this has not stopped the FEA from continuing a real paperwork empire that, frankly, has not delivered an extra barrel of oil to New England Electric System or saved its consumers a dime since January of 1974. Lack of any need for the program likewise has not stopped the allocation program at all. Every month we are required to tell FEA what we intend to burn in the way of residual oil for the next three months and then FEA turns around and tells us what we are intending to burn for the next three months and who our allocated supplies will come from. As a matter of act, the only oil we take from our allocated

suppliers is the oil that we do have under contract, which invaribly is much less than our total burn because we have been buying actively on the spot market for the past two years.

Another reason that we believe continued FEA controls are not in the consumer interest is the limitation that FEA places on our flexibility to do business. For instance, if it becomes advantageous to blend the product we burn in our boilers by mixing a lower sulfur fuel with a much higher sulfur fuel, we have to go back to FEA and get permission and go through another paperwork drill in order to do things that the oil companies have been doing throughout the past two years. We managed to set up a financing arrangement with one of the largest insurance companies in America to finance our fuel inventory. It took about four months before the insurance company could go through all of the regulations with FEA in order to make it look like the insurance company was actually storing and controlling the oil in order to comply with all of the FEA regulations. Really all we wanted from the insurance company was money to finance the inventory. But the regulations did not envision this type of operation. Finally, the FEA controls have tended to lock the large consumers, such as a utility, to certain historic suppliers. If these regulations are eliminated I would anticipate that many of the large consumers would be out checking other suppliers to obtain a better price than the ones they have been bureaucratically required to maintain.

If these controls expire on June 1 as proposed by FEA, what would we expect to see in the marketplace? The first thing I would expect to see is no change in the price because of decontrol. With steady demand there might be a small lowering of price over a long time period as utilities became more competitive by going to other suppliers and more utilities turned to the spot market as a way to meet their demands.

This doesn't say that the price of residual oil might not be increasing by the summertime because of rising demand. It will also increase any time the Arab oil cartel chooses to increase the price of crude oil. The other thing I would expect to see if the controls are removed is a tremendous saving in time and effort and costs throughout the oil industry, the utilities, independent oil operators, brokers, and resellers due to the elimination of the massive paperwork empire that has been built up over the past two years as FEA attempted to allocate and regulate prices in an area where the market is already doing the job--and doing it better.

FEA has been recommending decontrol of residual oil prices since at least August of 1974. FEA has recognized all this time that the market in fact has been controlling the price. Our company, New England Electric System, has supported each effort by the FEA to deregulate the control of residual oil. In August 1974 when this was first proposed it was interesting to see that the independent oil dealers in New England would not support the deregulation. However, within the last month when we checked back through the New England Council with industries throughout New England we find very few, if any, companies who think it is in their interest to continue this regulation.

For residual oil to maintain its relative price compared to crude oil and other refined products, it will be necessary to deregulate all other products that come from the refineries, as well as residual oil. Residual oil traditionally has been the cheapest part of the barrel to come from the refinery. However, during the mid-East war we saw that for the first time in history the price of residual oil reached a price higher than No.2 oil on a Btu basis (now the marketplace has restored residual oil to its normal relationship relative to other petroleum

and residual oil). We need to let the market keep the prices of products relative to crude oil in their historic relation which accurately reflect cost, supply and demand. The only way this can be accomplished is to ensure that we deregulate not only residual oil but all of the other major products as well.

In order to lower costs to the consumers there are several things that we think can be done in addition to eliminating the price controls and the allocation of residual oil. To reduce the market price of residual oil throughout the country it is necessary to reduce the market price of residual oil coming into the East Coast. Certainly encouraging conservation of all energy use in the whole nation is an important step, If we can reduce the demand, as a purchaser of residual oil, I can assure you that the marketplace will see that and it will reflect it in a lower price.

Another way to reduce the market price of imported residual oil is to increase the sulfur levels permitted to be used in various locations as long as these areas can meet the Federal clean air standards. In our own state of Massachusetts we have recently allowed the sulfur levels in residual fuel in certain areas to increase from 1% sulfur to 2.2% sulfur. This has allowed our company to buy residual oil at approximately $1.15 per barrel cheaper than before. This should be encouraged not only in Massachusetts but throughout the country where this can be done consistent with environmental standards. Another way to reduce the market price is to encourage nuclear power and coal burning as alternative fuels and encourage oil and natural gas production in this country and other countries beyond the control of the Arab nations.

An immediate way to reduce the market price of residual oil is to grant old oil entitlement tickets to the end users of foreign petroleum

products--primarily residual oil. The Federal Energy Administration made a step in the right direction in their recent decision to grant entitlements to importers of residual oil. They didn't go far enough, however. They gave the entitlements to the oil companies and oil importers rather than to the end users as we recommended. I feel certain that FEA's action will cause some reduction in the residual oil price. However, I am equally certain that the oil companies will swallow a portion of the value of the entitlement ticket as the market allows, whereas if these entitlements came to the utilities we would be required to pass the savings through the fuel clause dollar-for-dollar to the consumer. Finally, if we are really serious about lowering costs to the consumers, one step which could be taken immediately would be to eliminate the import license fees and import duties on residual oil. These fees and duties were put on the importation of foreign crude and products when foreign crude was cheaper than U.S. crude. Clearly, this is no longer the case. For the next 40 months at least, U.S. crude will be cheaper than the foreign crude because its price is controlled by law. If the argument is made that we need these import license fees and import duties to subsidize our refinery construction, I would suggest that there are alternative methods of subsidizing refineries. We estimate that today the price of 1% sulfur oil could be reduced from its present level of approximately $11.25/bbl. on the East Coast to about $7.50/bbl. by simply shifting a full entitlement to end users for every residual barrel of oil imported and by eliminating the import license fees and duties. There are things that are clearly within the purview of the Congress to control.

If the regulations are removed from residual oil, what would we do in the event of another shortage? If it's an embargo-type shortage,

I think it is necessary to maintain standby controls for residual oil as well as for all other products. I would expect that FEA, the second time around, could allocate in a much simpler fashion than they did the first time. All that's needed in my opinion is to "distribute the shortages." By this I mean that utilities or other end users that have more than the average of residual oil in storage would have some of the ships coming to their facilities diverted to companies that have less than the average. As long as this is done in a way that prevents one company from taking a cheaper oil than it has under contract from another company, I believe this would work. As far as the spot market is concerned there is nothing I think that can be done here except let the companies purchase on the spot market and, in my opinion, that market will provide the oil if the money is there.

In conclusion, we think the Federal Energy Administration is to be commended for attempting to get out of the regulating business where it is clearly counter-productive. We support the deregulation of residual fuel oil, on the understanding that it is the first step toward decontrol of all other major petroluem products.

STATEMENT OF

JOHN F. ANDERSON
MANAGER OF MATERIALS

ON BEHALF OF

THE DETROIT EDISON COMPANY

BEFORE THE

INTERSTATE AND FOREIGN COMMERCE
SUBCOMMITTEE ON ENERGY AND POWER

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 6, 1976

STATEMENT OF THE DETROIT EDISON COMPANY

BEFORE THE

HOUSE INTERSTATE AND FOREIGN COMMERCE
SUBCOMMITTEE ON ENERGY AND POWER

APRIL 6, 1976

My name is John F. Anderson. I am the Manager of Materials for The Detroit Edison Company. One of my principal responsibilities is to oversee the procurement of fuels, primarily coal and oil, for consumption at our power plants in the generation of electrical energy.

The Detroit Edison Company is a public utility which supplies electricity to approximately 1,600,000 customers in Southeastern Michigan, including the Metropolitan Detroit Area.

I have been informed that the Committee wishes the Detroit Edison Company to address itself to the following four questions:

1. What would be the consequences if the current world-wide surplus of residual oil were to turn into a shortage?

2. Assuming you favor standby controls, what criteria should be used to trigger those controls?

3. Should the controls imposed be in the form of price or allocation or both?

4. Can your company shift from the burning of residual fuel oil to distillates?

Taken in the order listed above, the company offers the following bservations, suggestions and opinions.

First, the impact upon the Detroit Edison Company of a worldwide shortage, absent United States Government intervention, would not depend so much on the impact of that shortage on the United States, but rather on Canada. This is because the company receives approximately 17,500bb/day, the bulk of its needs, from Canadian sources under long-term contract. Therefore, a shortage not affecting Canadian needs would, once again, absent U. S. involvement, have little impact on Detroit Edison. However, a shortage which did adversely affect Canadian needs would undoubtedly result in an adverse impact on the company's supply regardless of U.S. Government involvement.

At the present time the supply of residual fuel oil does appear adequate to serve the needs of the company and because of our long-term contract for this fuel supply, the company would not expect to see substantial price increases as a result of decontrol. Therefore, the company does favor the FEA proposal to decontrol residual fuel oil from the Mandatory Petroleum Allocation provisions of the Emergency Petroleum Allocation Act.

As to the second question, the Detroit Edison Company does favor standby controls. The controls should be triggered by a significant disruption of the market place like that which occurred during the Arab Oil Embargo or would likely occur during a war. Other disruptions which occur could trigger controls, when price increases over

some period of time indicate that refiners or marketers were attempting to pass along costs attributable to products remaining covered by the program to the purchasers of uncontrolled residual fuel oil. Another criteria might be the pricing of residual fuel oil by marketers or refiners at levels, when compared to other products still covered by regulatory control, higher than that relationship has been historically.

Concerning the third question asked, the Detroit Edison Company is firmly of the opinion that any controls reimposed must be both in the form of price and allocation controls to insure equitable treatment of all persons affected. In establishing allocations, the base usage of each generating unit should be utilized. The allocation system should also be flexible enough to recognize and deal with the unique transportation and delivery problems of supplying residual fuel oil to the Great Lakes region. Those problems center around the lakes' shipping season which restricts delivery to basically nine months of the year.

As mentioned earlier, the company receives most of its petroleum supplies from Canada and as such it has been continually discriminated against under FEA programs and policies due to the different discriminatory treatment this country applies to the importation of petroleum products from Canada into PAD-II-IV when compared to importation of foreign petroleum products into PAD-I. These policies have consistently led to increased costs to the people of Michigan which would not have occurred had the entire country been treated in the same fair and equitable

manner. Therefore, the company would strongly suggest that under any future programs established by FEA, it be required to treat the entire country in the same manner.

As to the final question asked, the Company does have the technical capability to convert its facilities from the burning of residual fuel oil to the burning of distillates. Based upon very preliminary studies, it appears that such conversion would take a minimum of 18 months and cause the company to incur significant capital cost. However, the company believes that it is highly unlikely that the quantities required to fuel those units with No. 2 oil would be available.

I would like to thank the Committee for this opportunity to testify for the Detroit Edison Company on these issues, and I will now be happy to try to answer any questions which you might have.

# # #

STATEMENT OF CONSUMERS POWER COMPANY

BEFORE THE

HOUSE INTERSTATE AND FOREIGN COMMERCE COMMITTEE
SUBCOMMITTEE ON ENERGY AND POWER

April 6, 1976

Presented by Robert B. Atwater

My name is Robert B. Atwater, and I am Executive Director of Fuel Supply for Consumers Power Company. Consumers Power is a combination gas and electric utility serving an area in the State of Michigan in which more than five (5.8) million people live. I am here today to testify concerning the Federal Energy Administration's plans for the decontrol of residual fuel oil and the impact of this action on the electrical generating side of our business.

Further, I intend to bring to the Committee's attention the grossly inequitable treatment by the Federal Energy Administration (FEA) of Consumers Power Company and its customers due to the discrimination against Michigan utilities under the oil entitlements programs and the import fee system.

The two key questions to be answered concerning the exemption of residual oil from regulation under section 4(a) of the Emergency Petroleum Allocation Act of 1973 are: (1) Do sufficient competition and market forces exist to provide adequate protection for the consumer? and, (2) Would such an amendment result in inequitable prices for any class of user?

Regarding the first question, it is clear from the Company's experience in our market area for residual fuel oil that the answer is "yes." Average residual oil prices

at our Morrow Plant near Kalamazoo, Michigan were approximately 11.9¢/gallon in December of 1972, 24.3¢/gallon in December of 1973, and 30.9¢/gallon in December of 1974. Residual oil prices stabilized during the first half of 1975 and dropped slightly during the second half of 1975. At the present time the average price is about 26.7¢/gallon. The effective drop in price from mid-1975 is about $1.76 per barrel and greatly exceeds the effective roll back of average crude oil prices implemented earlier this year. The price drop is also testimony to the fact that there is now sufficient residual oil in our market area to serve demand and that market forces are protecting the consumer.

The answer to the second key question is not so clear. While the exemption of residual oil from regulation may not create a further inequity, it certainly does nothing to correct the price inequities that have existed and which have been intensified by the FEA's companion move to amend the entitlements program. These latter regulations, as presently framed, are flatly contradictory to the requirements of the Emergency Petroleum Allocation Act ("EPAA") and to the basic principles of equity and fair dealing which bind together the diverse regions of this country.

The fundamental purposes of these new entitlement regulations is to roughly equalize the prices of imported and domestic residual fuel on the East Coast. FEA has determined that, because large quantities of imported residual fuel are used in that area, and because the businesses of a large number of importers and Caribbean refiners are affected, relief to product importers in the form of product entitlements is warranted. But the underlying situation on the East Coast is no different from that in the State of Michigan. Further, there is no difference in fact or law which would justify the granting of a subsidy to East Coast importers, and not to those in the rest of the country.

This was recognized in the previous product entitlements program which was in effect from late 1974 through early 1975. Under that program, the geographic location of the importing firm was not relevant to its eligibility for entitlements. Consumers Power, which was an eligible firm under that program, received product entitlements with respect to its imports for a limited three month period.

The grant of a subsidy such as product entitlements on a geographically discriminatory basis violates the clear mandate of the EPAA to provide for "equitable distribution of crude oil, residual fuel oil and refined petroleum products at equitable prices among all regions and areas of the United States. . . ." The grant of product entitlements to East Coast importers, but not to importers in the rest of the country, is clearly inconsistent with the Congressionally mandated goal of providing for "equitable prices among all regions."

Consumers Power will import approximately 7 million barrels of oil, including crude oil, from Canada for direct firing in our electric generating units at Essexville, Michigan. This oil is defined in various FEA regulations either as crude oil or as residual oil. If this Canadian oil carried the "crude oil" label and if the Company were eligible for entitlements, the 1976 cost of fuel passed through to our customers would be reduced $17,500,000 based on January 1976 entitlement value and old crude oil ratio, or $20,300,000 based on the present estimated entitlement value. If this Canadian oil carried the "residual oil" label and if the Company were eligible for entitlements under the recently modified program, the 1976 cost of fuel passed through to our customers would be reduced between $5,100,000 and $6,100,000.

While the Canadian oil is defined as "crude oil" in the recently enacted Canadian Crude Oil Allocation Program, we are still required to pay the 63¢ per barrel import

license fee for "residual oil" instead of the 21¢ per barrel fee for "crude oil." The annual additional cost to our customers is $2,900,000.

In summary, Mr. Chairman, Consumers Power Company supports the exemption of residual oil from regulation. We must protest, however, in the strongest possible terms, that the FEA allocation and entitlements program will cost our 1,200,000 electric customers a minimum of $8,000,000 and as much as $23,200,000 per year. This gross discrimination by regulation places an intolerable and unnecessary burden on our electric customers, and is clearly contrary to the intent of Congress.

While we favor in principle the deregulation of residual fuel oil, we also believe that the package of proposals and regulations put forward by the FEA fails to achieve the dictates of Congress, which should be rejected by Congress until such time as the package is rendered just and equitable.

Thank you for allowing me this opportunity to express our views on this matter, and I would be happy to answer any questions.

Comments of the NEW YORK STATE

Emergency Fuel Office submitted

to the Congress of the United States,

Committee on Interstate & Foreign

Commerce, Subcommittee on Energy and

Power

Washington, D.C.

April 6, 1976

Re: Federal Energy Administration Proposal

to Remove Residual Fuel Oil from

Price and Allocation Controls

Comments of the New York State
Emergency Fuel Office submitted
to the Congress of the United States,
Committee on Interstate & Foreign
Commerce, Subcommittee on Energy
and Power
April 6, 1976
Washington, D. C.
Re: Federal Energy Administration
Proposal to remove Residual
Oil from Price and Allocation
Controls

Salutations:

My name is Lorna Rissier Bernard, Counsel to the New York State Emergency Fuel Office which is the office certified by the Federal Energy Administration (FEA) as the State Office of Petroleum Allocation. I am pleased to have the opportunity to speak to you today on behalf of the State of New York.

The Federal Energy Administration (FEA), after public hearings, has submitted to the Congress of the United States a proposal to remove residual fuel oil from price and allocation controls. The State of New York respectfully submits that this course of action would have disasterous implications for the State of New York, indeed for the entire East Coast. In consequence, we implore the Congress to disapprove this proposal.

In order that you correctly understand New York's position a little background may be necessary. The FEA has been attempting to dismantle allocation and price controls in whole or in part almost from the inception of the Emergency Petroleum Allocation Act of 1973 (EPAA-73).

On July 22, 1974 the FEA proposed to discontinue the allocation program for residual fuels. This effort was resisted not only by New York but also by Massachusetts, New Hampshire, Connecticut, Maine, indeed, by the New England Congressional Caucus. The resistance was successful in large part because of a faulty conclusion of the FEA, i.e. the quantities of available residual fuel oil as reported by FEA exceeded the available storage.

On November 18, 1975 the FEA submitted proposals with reference to the state set-aside program. It held hearings in the various regions not to

determine whether or not the state set-aside program should be dismantled but only as to which dismantling system should be used. This effort was again successfully resisted.

Recently, on March 2nd and 9th, 1976 the FEA again held hearings with reference to the entitlements program and the proposal now submitted to you.

Ordinarily one would applaud, indeed encourage, any governmental agency in its effort to self distruct any part of its bureaucracy. However, these are not ordinary times and the program they wish to destroy is not an ordinary nor unnecessary program.

The position of the State of New York is that the allocation and price control program is a tool of conservation and equalization of the economic burden throughout the nation. We have consistently begged the FEA to come back to the Congress of the United States to secure the additional authority needed to conserve all of our energy resources and to equalize the prices on the basis of btu content. It is wasteful at best to dismantle a program either piecemeal or in its entirety at the very time when the Congress has directed the implementation of national conservation programs.

The word "surplus" is an insidious misnomer calculated to lull the unwary into a false sense of security. There is no surplus of oil in this country. We import more today than at any other time in our history. There is no world wide surplus of oil, only a current short-term "glut". There is only the question of whether we run out sooner or little later. There is no world wide surplus of natural gas. The only question again is do we run out sooner or later. Even coal is finite whether we liquify it or gasify it or perform any of the other high-priced miracles on it that our technology allows. In our efforts to conserve finite fossil fuels we must completely re-order our priorities. We must decide if we are going to use our petrochemicals to make

disposable styrofoam cups or insulation. We must decide whether we are going to use our natural gas to dry our crops or to burn in our furnaces.

We must not only re-order our priorities with respect to one energy source, we must come to the realization that all energy resources must be re-examined.

The FEA recently changed its program with reference to entitlements in response to industry demands. A quirk in the regulations which gave one company an unfair advantage over other companies has been changed. This change is supposed to make more equal the status of oil suppliers which import foreign residual oil from foreign Caribbean refineries with the unique position of Amerada Hess which purchases foreign crude oil in the Caribbean and processes it in its domestic refinery in the Virgin Islands. The change is intended to equalize prices among oil suppliers. It does not nor is it intended to equalize the price of energy resources throughout the nation.

Close on the heels of the March 2nd hearing on entitlements, on short notice, in fact one week later, on March 9th the hearing on the proposal to exempt residual fuel oil was held. We testified at that hearing. I am submitting copies of that testimony today to the members of this committee in the event that you have not as yet read it. For those who have read the testimony what I say now may be repetitious but it bears repeating.

The FEA made a number of preliminary findings on which they based their intention to remove controls on residual oil. We contested and we do now contest their findings. They are in error!

Preliminary Finding (3) is that:

> "The residual fuel oil market share of large, integrated refiners has been decreasing since 1972, while that of the large independent and small refiners has been increasing. However, continued controls could lead to a deterioration of competition, resulting in reduced economic efficiency and higher prices."[1]

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1. Federal Register, February 17, 1976, Vol. 41, No. 32, p. 7124, Col. 1

Again we are at a loss to understand their reasoning. Does it occur to no one, except to those of us in Petroleum Adiministration for Defense District I (PAD I) who are so vitally affected by the findings of the FEA, that the reason for the increased market share of the independents has been a result of, and not in spite of, the controls? Is competition not then enhanced by controls? Let us look at what has happened before we make the dire prediction that "continued controls could lead to a deterioration of competition." And let us not forget that one of the mandates given the FEA by the Congress has been to protect the large independent and small refiners.

The FEA continues with a Preliminary Finding (4) that:

> "It is not anticipated that there will be any adverse state or regional impacts resulting from the proposed exemption." [2]

How is this possible when 92% of the nations imported residual oil,[3] which is more expensive than domestic, is consumed in PAD I? We are at a loss to understand how the FEA arrived at its conclusion especially in the view of the overall price of energy resources on the East Coast which is in PAD I. The prices for residual fuel oil to resellers are now more than 3¢ per gallon higher on the East Coast than the price for the nation as a whole. The price differential of residual oil, if exempt from the regulations, will no doubt rise to the level of other fuels. Interstate natural gas and electric rates in New York State are nearly twice the national average while coal is half again as expensive. [4]

Preliminary Finding (1) is that 80-90% of the East Coast's residual fuel oil demand has traditionally been supplied by Caribbean imports.[5] The FEA then states that an unspecified increased percentage of the demand has been satisfied

2. Ibid, Col. 2
3. Mineral Industry Surveys, "PAD Districts Supply/Demand," U.S. Department of Interior, Bureau of Mines, Table 2, October 10, 1975
4. Federal Power Commission, News Release No. 20871, 11/22/74, U.S.F.P.C. "Typical Electric Bills", January 1974, and Federal Power Commission, News Release No. 2087 11/22/74.
5. Federal Register, 2/17/76, Vol.41, No. 32, p. 7124, Col. 2

by "domestic refining." We ask how much of an increase? We also ask what is being domestically refined? We all know that the United States is importing more crude oil today than at any time in our past history despite the cut backs imposed by the Canadian government. This crude oil is being domestically refined. But the refining process does not make the product domestic. The phraseology of this finding is most unfortunate. Moreover, we believe it should be pointed out that we are not only importing crude oil from abroad but we are now importing residual oil as well from such additional countries as the Union of Soviet Socialist Republics, Japan and from African nations.

The FEA also stated that:

> "Because supplies of crude oil and refined petroleum products have generally been sufficient since the end of the 1973 oil embargo..., it has been apparent for some time that the complex regulatory program created for the embargo shortage period may no longer be necessary..."[6]

We agree that a "complex regulatory program" is no longer necessary. We have offered suggestions to simplify the regulations. Is there no way to deal with an overly complex system except to abolish it?

Just what are residual fuels? What are we talking about? Residual fuels are Nos. 4, 5 and 6, Bunker C, and Navy Special. Large industries or apartment complexes may use either No. 4 or No. 6 because of its greater btu content than No. 2. However, most of No. 6 is used in large industries or electric generating plants.[7] It is the life blood of the economy of the North East.

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6. Ibid, p. 7122, Col 1

7. Uses of Residual Oil in New York State:

Utilities	50%
Apartment Houses and Institutions (Such as hospitals, prisons, shopping centers, psychiatric institutions)	34%
Industry	6%
Other	10%

Source: New York State Public Service Commission, Consumption of Energy in New York State, O.R. Report No. 2, February 1975

As Congressman Benjamin A. Gilman (R 26-New York) stated: "...approximately two-thirds of the residual oil consumed in the United States is used on the East Coast... (Moreover), the requirement for low sulfur fuel oil, which is of necessity primarily refined from foreign crude oil... (has forced the) whole East Coast (and other urban areas) to bear a disproportionately higher fuel cost."[8] Sixty-One (61%) percent of all residual oil is consumed in PAD I. [9]

Instead of exempting residual oils or any other product from the Mandatory Petroleum Allocation and Price Regulations we should reshape the regulations to make it more workable and make it more in tune with our primary goal of conservation.

The intent of Congress with reference to conservation is clear. If in hammering out a compromise the authority delegated to the Federal Energy Administration over all energy resources for the purposes of conserving them was insufficient to do the job, then they should ask for additional authority to regulate all energy resources in this time of impending disaster.

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8. Testimony submitted 3/2/76, FEA Hearing, Washington, D.C.

9. Mineral Industry Surveys,"PAD Districts Supply/Demand," U.S. Department of Interior, Bureau of Mines, Table 2, January 29, 1976

STATEMENT OF R. L. BERRY

VICE PRESIDENT

ROYAL PETROLEUM

Subsidiary of S. W. Refining Co.
Subsidiary of Kerr-McGee Corp.

before the

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

SUBCOMMITTEE ON ENERGY AND POWER

April 6, 1976

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Kerr-McGee Corporation wholeheartedly supports the decontrol of petroleum products. We also support the decontrol of residual fuel oils as a first step. However, the particular residual fuel oil decontrol program which has been presented does have adverse financial consequences for domestic refiners selling residual fuel oil on the East Coast.

Kerr-McGee Corporation has made substantial investment to increase refining capacity in order to meet anticipated expanding need for domestic petroleum products. We are now confronted with the prospect of substantially under-utilizing these expanded facilities because of the current rule-making on residual fuel oil. The table below illustrates the magnitude of changes undertaken by Kerr-McGee Corporation to provide greater national self-sufficiency in refined products.

	Pre October 1973	M B/D	Current 1976
Refinery Runs	90		180

Under the regulations covering residual fuel oil, Kerr-McGee is confronted with the prospect of large losses resulting from inability to recover costs associated with the manufacture of residual fuel oil produced for sale on the East Coast, while offshore refineries will be encouraged to expand operations at the expense of domestic producers. We have estimated these losses based on the following assumptions.

(A) East Coast residual fuel oil prices will remain unchanged (this is an FEA assumption based on their belief that a theoretical cost balance has been struck between domestic producers and importers).

(B) Kerr-McGee maintains current level of operations and delivers 20,000 B/D low sulfur residual fuel oil to the East Coast.

Our losses on sale of low sulfur residual fuel oil become (based on estimate of March, 1976 results):

		$/BBL
Sale price of residual fuel oil in New York		12.40
Cost of sales:		
Crude cost and other purchased raw material and non-product costs	12.33	
Transportation cost and terminal expense	.95	
Reverse entitlement cost effect	1.10	
Total cost of sales		14.38
Loss/bbl		(1.98)
Loss in $/day on 20,000 B/D Sales		$ 39,600
Loss in $/month on 20,000 B/D Sales		$ 1,227,600
Loss in $/year on 20,000 B/D Sales		$14,454,000

Please keep in mind that we have examined and studied the text of the regulations only since April 2, 1976, and therefore, qualify the above indication as being our best estimate of the adverse consequences of the regulations to our company.

We continue to advocate total decontrol of the petroleum business as the best prospect to effectively improve the nation's energy self-sufficiency. However, the utilization of entitlements in adjusting costs of residual fuel oil is inconsistent with decontrol, as is any restriction which prevents the logical allocation of costs between products in a refinery operation.

If, however, ultimate decontrol can only be achieved by a step by step

decontrol procedure, then we caution against a rigid system of cost allocation between products. In the past, a certain flexibility in transferring cost between products was essential for domestic refining operations to be profitable. Under the new regulations, increased crude costs are allocated to residual fuel oil on a volumetric basis. This means residual fuel oil will carry as much increased crude costs as will gasoline and other higher value products. Residual fuel oil cannot be sold profitably when costs are allocated in the manner. We feel increased crude oil costs should be allocated to residual fuel oil as has been done historically. This means residual fuel oil should be allocated a proportionately smaller amount of increased crude oil costs than are allocated to other refined products.

We appreciate the opportunity to present this information to this forum.

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Statement

of

JOHN G. BUCKLEY

on behalf of

ENERGY CORPORATION OF LOUISIANA

before the

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES

Washington, D. C.

April 6, 1976

Mr. Chairman and members of the Committee. My name is John G. Buckley. I am a Vice President and Director of Northeast Petroleum Industries, Inc. of Boston, Massachusetts. I am also a Vice President and Director of the Energy Corporation of Louisiana (ECOL). ECOL is a new joint-venture independent refining company owned 50% by the Ingram Corporation of New Orleans and 50% by Northeast Petroleum.

ECOL is currently completing construction of a 200,000 b/d oil refinery at Garyville, Louisiana, about halfway between New Orleans and Baton Rouge. The ECOL refinery, which is due on stream in October of this year, is the largest refinery ever built on the U. S. mainland in a continuing single construction phase and is the first major new independent refinery built in the United States since the 1950's. The ECOL plant also is the first European-type fuels refinery ever built on mainland U. S. soil. When we are in full operation later this year we shall be producing about 50% residual fuel oils and another 25% light fuel oils such as No. 2 home heating oil and diesel fuel.

Background

With such a heavy emphasis on fuels production, we have been constantly monitoring both the supply and demand for fuels in the United States for the past three years. As you can ap-

preciate, Mr. Chairman, it has been a volatile period with shortages, embargoes, skyrocketing prices and a great deal of uncertainty both in the world market and here at home. During 1973, when this Committee was considering the Emergency Petroleum Allocation Act of 1973, our company strongly supported the adoption of an allocation system. Indeed I think it is fair to say that the action of this Committee and the Congress in establishing the allocation program at that time saved many hundreds, indeed perhaps thousands, of independent oil marketers, wholesalers and retailers from oblivion. There was a need and this Committee responded to the need. Independent oil marketers and refiners deeply appreciate your foresight and leadership in enacting legislation which quite literally saved our businesses.

By saving us, of course, you also saved the most competitive element in the petroleum industry and thus served your constituents--the consumers of the United States--by assuring for them the benefits of a competitive market.

Time has, of course, moved on. Conditions have changed dramatically.

Need for Decontrol

We have carefully studied the Federal Energy Administration's Findings and Views relating to the exemption of residual

fuel from price and allocation regulations*/ and find that we agree with the substantive conclusions of that report.

As a new independent refiner making a $300 million capital investment in a new facility, we would be the last to urge the scrapping of controls on residual fuel if we felt that the continuation of such controls would offer us a "security blanket" or in some way guarantee our economic viability. Yet, we favor decontrol and so testified at the FEA hearings on March 3 and again on March 9, 1976.

Our reasons are quite simple. We believe that the allocation and price control system now in effect harms independent refiners and independent marketers more than their major integrated competitors. At a time when both foreign and domestic supplies are ample it is the small independent who is hurt by controls more than his giant competitors. We independents have the ability to act quickly and take advantage of world market trends in buying crude oil, and in arranging freight. We can also act quickly in making attractive sales to new customers. Generally we are able to "outsell" our slower-moving major competitors by offering better service and better prices to customers. This has been the essential element in our growth and prosperity in a free market economy. All of these advantages are lost when we are plagued by a mass of red tape, caught in a

*/ "Findings and Views Concerning the Exemption of Residual Fuel Oil from the Mandatory Petroleum Allocation and Price Regulations", Federal Energy Administration, March 29, 1976.

tangle of controls and monitoring, and hobbled by fixed purchaser/supplier relationships.

In short, my company, Northeast Petroleum, has grown over the last fifteen years in "tight" markets and in "ample" markets by its ability to outsell our major competitors in the region of the country in which we operate. We expect ECOL, our new independent joint-venture refining company, to be able to perform the same way. Our accomplishments and our growth have been achieved in the marketplace. We are not afraid to compete in that marketplace. Indeed we welcome the test and the challenge of the market because we believe we can grow and prosper and the consumer will benefit if we are allowed to exercise our judgment and utilize our ability to move quickly.

Unfortunately the allocation and price controls imposed on the industry negate, under current market conditions, most of our natural competitive advantages. That is why we favor removal of residual fuel oil allocation and price controls at this time.

Standby Controls

We recognize that should another embargo develop, with massive cutbacks in the availability of crude oil and residual fuel supplies, our company and indeed, all independent companies, would once again be threatened with extinction. This Committee wisely provided in the Energy Policy and Conservation

Act that allocation and price controls remain on a standby basis, ready to be reimposed promptly if conditions warrant. In accordance with the Act, FEA plans to maintain residual fuel oil controls on a standby basis. We think this procedure will give us ample protection should another emergency occur. In the meantime, we believe that our company and other independent refiners and independent marketers, both wholesalers and retailers, as well as the consumers of the United States will be served if controls on residual fuel oil are removed at this time.

FEA Findings

While the foregoing represents our judgment of the advisability of decontrolling residual fuel prices now we would like for the record to indicate that we specifically agree with the following major findings of the Federal Energy Administration:

1. Residual fuel oil supply is ample. Excess refining capacity exists both in the United States and abroad and should be sufficient to satisfy projected U. S. demand for this fuel.

2. Exempting residual fuel oil from allocation and price controls will not adversely affect the supply of any other petroleum product.

3. Competition and market forces will protect consumers after residual fuel oil is exempt from regulations. Indeed competition should be increased since current controls inhibit competition.

4. There should be no price increases resulting directly from decontrol.

5. Exempting residual fuel from controls will have a positive effect on the competitive posture of small and independent refiners and marketers.

6. Consumers will be better off. They will be able to seek the lowest cost supplier by using competitive bids without regard to fixed supplier/purchaser relationships.

Conclusion

Mr. Chairman, in conclusion, I would like to thank the Committee for providing us an opportunity to comment on the advisability of exempting residual fuel oil from both price and allocation regulations. ECOL strongly urges that this Committee, in accordance with the procedures under Section 455 of the EPCA, permit the Federal Energy Administration's exemption proposal to become effective on June 1, 1976. It will help us as a new independent refiner, it will help other independent refiners, and independent retailers and wholesalers. Most important, by helping the independent sector of the industry Congress will help the consumer. I shall be pleased to answer any questions that the Committee may have.

Thank you very much.

Statement Of Edward M. Carey
On Exemption Of Residual Fuel Oil
From The Mandatory Petroleum
Allocation And Price Regulations

Before The Subcommittee On
Energy And Power Of The
House Committee On Interstate
And Foreign Commerce

April 6, 1976

Mr. Chairman, I am pleased to appear today before your subcommittee on behalf of New England Petroleum Corporation to consider the Federal Energy Administration's proposal to remove price and allocation controls from residual fuel oil effective June 1, 1976.

In materials accompanying its February 12, 1976 proposal to decontrol residual fuel oil and an integrally related proposal to modify the old oil entitlements program, FEA has ably analyzed the impact which price and allocation controls have had on the east coast residual fuel oil market. In adopting a final rule on modifications to the entitlements program and a final proposal on decontrol of residual fuel oil, FEA has made as valid a forecast as anyone can make of the price and supply consequences of decontrol of residual fuel oil.

Because my company has been uniquely affected by FEA's programs over the past two years, I would like to prevail upon you to review briefly our history over this period so that you might better understand our perspective on decontrol, the subject of this proceeding.

As FEA's Findings and Views points out, the market for residual fuel oil in the east coast states is principally an import market. Further, five Caribbean-based refiner/importers historically have accounted for approximately 80% of this market: Amerada Hess Corporation, Asiatic Petroleum Corporation (a Shell affiliate), Exxon Corporation, New England Petroleum Corporation,

and Texaco, Inc. Of these five companies, only Amerada Hess is considered to be a domestic refiner under FEA's programs, even though it is outside the customs territory of the United States.

Since August 1973, we have had a system of price controls under which certain domestic crude oil is priced well below market levels. Up until the end of the Arab Oil Embargo in the spring of 1974, whether a refiner had access to low cost domestic crude oil did not affect its ability to sell product on a profitable basis. However, in the period of ample supply following the end of the embargo, a refiner with high crude oil costs found that it could not profitably compete with a refiner which had access to low cost domestic oil.

Access to low cost domestic oil (beyond equity oil), and the attendant chaotic impact on the east coast residual fuel oil market, came in two stages to Amerada Hess, the one "domestic" refiner/importer serving this market. In June 1974 Amerada Hess became a buyer under the refiner Crude Oil Buy/Sell Program. Since sales under this program were made at the seller's composite cost, a buyer obtained partial access to low cost domestic crude oil. We have estimated in filings with FEA that this access was worth between $0.53 and $0.84 per barrel to Amerada Hess during the period prior to the adoption of the entitlements program at the end of 1974.

Adoption of the Old Oil Entitlements Program completed the process of granting Amerada Hess full access to the FEA-created

benefits of low cost price controlled domestic oil and effectively superseded the cost benefits of the Buy/Sell Program. NEPCO calculated that its crude oil cost disadvantage vis a vis Amerada Hess at the start of the entitlements program was $1.58 per barrel, assuming that both companies' crude oil acquisition costs were otherwise equal. The identical crude oil cost disadvantage also affected the other refiner/importers in the market.

Because of changes in the national old oil supply ratio, the supplemental fee structure, and the value of an entitlement, the Amerada Hess crude oil cost advantage was not constant through 1975, but ranged between $0.91 per barrel and $1.86 per barrel, except for the last few days of the year when it reached $3.00 per barrel.

NEPCO first applied for relief by way of an exception to the regulations in February 1975. We applied four more times in 1975. Based on these applications, we received relief totaling approximately $31.1 million. This is a substantial sum of money by any person's measure, but it is not so large as it might appear. NEPCO received relief covering six particular months. The formula under which relief was measured was designed to give NEPCO the same crude oil cost reduction as Amerada Hess with respect to approximately 60% of NEPCO's residual fuel oil imports during those six months. This relief was not enough to make NEPCO profitable on residual fuel oil sales and actually hurt NEPCO with respect to the adverse publicity surrounding its financial condition.

No other firm successfully obtained relief from FEA for this problem because the standards applied by FEA for granting relief required that a firm's overall financial picture be adversely affected. Exxon, for example, could not meet this test notwithstanding large losses in the particular market we are talking about.

In contrast, the modifications to the old oil entitlements program which FEA adopted at the same time it transmitted its decontrol proposal to the Congress diminished the Amerada Hess advantage to approximately $0.60 per barrel by partially removing Amerada Hess' entitlements with respect to residual fuel oil production, and granting partial entitlements to importers of residual fuel oil. NEPCO believes that while these permanent modifications to the program are more desirable than FEA's various exception awards have been, the entire Amerada Hess advantage should have been eliminated.

We believe that a free market in residual fuel oil will achieve at least as much benefit to the consumer as price and allocation controls.

In our view, whatever price movements occur in the residual fuel oil market over the next period of time will not be related to decontrol. The market is highly competitive, and, because all factors save Amerada Hess have had to absorb costs to stay competitive, there are cost banks sufficient to allow considerable upward price movement even if price controls

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remained in effect. This is not to say that upward price movement is expected. We do not expect it. What I am saying is that market conditions will determine prices and there is enough latitude for price movement under FEA's regulations to render them irrelevant.

As FEA has also pointed out there is more than ample idle refining capacity to meet any reasonably foreseeable demand increases in the future. And finally, in the unlikely and undesirable event that supplies once more become scarce, FEA retains the power to reimpose controls.

I thank you again for this opportunity to present our views.

New England Fuel Institute

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Statement

of

NEW ENGLAND FUEL INSTITUTE

before the

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES

Washington, D. C.

April 6, 1976

Mr. Chairman:

Thank you very much for the opportunity to testify before you. My name is Robert DeBlois. I am President of DeBlois Oil Company, an independent retail fuel oil dealer in Pawtucket, Rhode Island. I am a member of the Board of Directors and the Fuel Oil Supply Study Committee, a past President and Chairman of the Board of the New England Fuel Institute (NEFI). With me today is Mr. Charles H. Burkhardt, Executive Vice President and Managing Director of NEFI.

NEFI is an association of 1,300 independent retail and wholesale home heating oil distributors throughout the six-state region. The independent marketers serve over 2.4 million retail home heating oil consumers and market 85% of the 4 billion gallons of No. 2 home heating oil sold in our area at the retail level and 40% of the gallonage at wholesale. Seventy percent of all of New England's homes and 74% of its population are heated by No. 2 home heating oil. Members of our association also market residual fuel oil at the wholesale and retail levels.

I am appearing today on behalf of NEFI in support of the FEA proposal set forth in the Federal Register Notice of April 1, 1976 on the "Exemption from Mandatory Petroleum Allocation and Price Regulations of Residual Fuel Oil", 41 F.R. 13896 (F.R. Doc. 76-9339).

<u>NEFI Supports FEA's Conclusions</u>

Our Association strongly supports FEA's proposal to exempt residual fuel oil from allocation and price controls, and we are pleased that this proposal is now pending before Congress. We view such action as a first step toward decontrol of all finished products--a position we have strongly advocated for the past six months. It is generally recognized that controls on product have been unnecessary as well as counter-productive for almost a year. FEA's "Findings and Views" make that point eloquently.

. Residual fuel oil is not in short supply.

. Decontrol will have no adverse impact on the supply of other products.

. Competition and market forces will protect the consumer.

. Continued controls will lead to a deterioration and eventual destruction of competition.

. No general price increases are expected from decontrol.

. Marketers will be permitted to shop around for the lowest possible price supplier.

. Decontrol will have no adverse impact on goods or services to the consumer.

. Current prices for domestic and foreign residual fuel oil are relatively equal.

FEA's analysis of each of these points is factual and accurate and demonstrates a full understanding of market forces

and competitive interplay as well as the impact decontrol will have upon it. NEFI concurs in the findings and asks Congress to permit the implementation of decontrol of residual fuel oil pursuant to the Energy Policy and Conservation Act.

Decontrol Would Not Result in Supply or Price Difficulties

Only a small number of our members are marketers of residual fuel oil in the New England area. However, as retailers of No. 2 fuel oil--a closely related product--we have a basic understanding of the problems that exist in that market. FEA's own study is consistent with the conclusion of NEFI's Fuel Oil Supply Study Committee that there are no foreseeable supply or demand problems with residual fuel oil. Demand for most grades of residual fuel oil should remain constant for the next several years. Residual fuel oil is less susceptible to major seasonal variations than are other products. This factor permits more accurate estimates of supply and demand.

Further, we do not believe that decontrol will result in any significant change in price; in fact, we foresee general price stability in residual fuel oil as a result of FEA's solution to the Amerada Hess problem implemented by final rule as a modification of the entitlements program. 41 F.R. 13899 (April 1, 1976).

We strongly believe that any increase in prices will be unrelated to the elimination of controls. Congress must realize that if residual fuel oil prices rise, it will be a direct re-

sult of increased foreign and domestic crude costs within the next two years. Most marketers of residual fuel oil are presently selling far below their allowable margins and are not recovering their full costs; as crude costs increase, residual fuel oil prices would increase correspondingly even if controls are retained. However, if residual fuel oil is exempt from controls, additional competition will effectively restrain most price increases and will actually lessen the cost to marketers and consumers.

<u>NEFI Seeks Immediate Decontrol of Residual and No. 2 Fuel Oil</u>

Our examination of the residual fuel oil market demonstrates that there is no reason why decontrol of that product should be delayed. Each week of continued controls only means further deterioration of competition, higher prices and injury to the independent marketer and the consumer.

As marketers of both residual fuel oil and No. 2 home heating oil, we view decontrol of residual fuel oil as an essential first step in the decontrol of all products, particularly home heating oil. In the case of No. 2 fuel oil NEFI believes there is ample supply and has concluded that decontrol should be implemented so that the retail dealer and the consumers he serves can be assured of the lowest possible prices for that product as well.

Decontrol Will Stop Precipitous Retail Price Rises

A short study of the history of price acceleration at the retail level in the No. 2 home heating oil market of New England serves to demonstrate that the direct result of price controls is to accelerate in a geometric progression increases in the retail price of fuel oils. When price controls and then allocation controls came into being, the price of No. 2 home heating oil in New England was 21.9¢ per gallon. Today, less than four years later, the price is 42¢ per gallon. A doubling took place in less than four years under controls.

In 1951, the price of No. 2 home heating oil at the retail level in New England was 10¢ per gallon. In late 1972, it was 21.9¢ per gallon. It took 21 years in a free market, without governmental control interference, to double the price of heating oil. It took 42 months under government controls to achieve the same price rise. In other words, under control, prices accelerated geometrically. Just what good has price control done for the independent heating oil distributor or the consumer?

Conclusion

Prompt decontrol of residual fuel oil is essential to ensure a healthy and competitive petroleum industry as well as to ensure lower prices to the consumer. We therefore ask Congress to allow the exemption of both products from the Mandatory Allocation and Price Regulations in accordance with the procedures established by the Energy Policy and Conservation Act.

Thank you very much.

Testimony of

Robert B. Greenes

Offerred in Behalf of the

National Oil Jobbers Council

Before the

House Interstate and Foreign Commerce Committee

Subcommittee on Energy and Power

on the

Exemption of Residual Fuel Oil

April 6, 1976

My name is Robert Greenes. I am testifying on behalf of the National Oil Jobbers Council in which I have served in the past both at the national level as President and as Fuel Oil Chairman and in New York State as President of the Empire State Petroleum Association. NOJC is a federation of 42 state and regional trade associations representing thousands of independent small businessmen who market petroleum products. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residual fuel oil. Together our members market approximately 75 percent of the home heating oils and 25 percent of the gasoline sold in America under either their own private brand or the trademark of their supplier.

The Council has asked me to speak for them today because I am a residual fuel oil marketer. My company, Public Fuel Service, Inc., sells both distillate and residual fuel oils in the New York City area where I presently serve as the Chairman of the Residual Fuel Oil Committee of the New York Oil Heating Association. With your permission, Mr. Chairman, I shall not, however, restrict my remarks to the narrow question of whether the Congress should permit FEA to deactivate the allocation and price controls on residual fuel oils. Rather, I hope to explain clearly to this Committee the anti-competitive and anti-consumer effects of perpetuating price and allocation controls during a surplus.

Recognizing the existence of a surplus, this Committee wisely charged the FEA with a duty to review the current effect of its regulations and it provided FEA with a procedure by which the Congress could review that Agency's findings and, if appropriate, permit conversion of unneeded controls to a standby basis. You have before you today the first results of that procedure.

More than anyone else, the members of this Committee are aware of the deep mistrust small businessmen such as myself have for the Federal Energy Administration. I was President of the National Oil Jobbers Council during the year in which the Emergency Petroleum Allocation Act was adopted. I know that our decision to embrace controls was the right decision at that time. It served the public interest and it served the interests of marketers who might otherwise have been without supply. But I can also say that had we known that the FEA would conduct its responsibilities as it has, we should not have been so public spirited. The truth of the matter is that in too many cases marketers got through the shortage despite rather than because of the regulators. The basic goals of the Allocation Act were reached but at an unreasonable cost in confusion, misinterpretation, and delay.

I understand that this is not an oversight hearing. I emphasize the mistakes which FEA has made only to demonstrate that I do not easily accept their analysis. Yet, I have reviewed their Findings; and, I believe their facts are thoroughly assembled and their reasoning is unshakeably sound. When FEA proposed decontrol of residual fuel oil in August 1974, I could not make that statement. At that time I appeared for NOJC at the FEA public hearing on that proposal to express the Council's strong opposition. But, today, I am convinced that the price and supply situation is clearly such that controls are unnecessary. In fact, controls are in many instances an obstacle to competition which would otherwise develop.

The Findings submitted by FEA in support of its proposal to decontrol residual fuel oils correctly concludes that the market mechanism currently regulates sales of residual fuel oil more efficiently and more strictly than do FEA's regulations. Moreover, there is every reason to expect the market mechanism to continue working for a long time to come. There is an adequate supply of residual fuel oil and there will be adequate supply to meet any foreseeable needs. Adequate supply should, in turn, assure availability to all users and marketers at competitive prices. Despite an enormous difference between world and domestic crude oil costs, the world price of resid is close to the domestic price. In fact, as with almost every product, residual fuel oil sellers have banks of unrecouped product costs. These banks prove that adequate supply establishes a market price lower than the legal ceiling under the regulations.

The problems that do remain are associated with the continuation of regulations governing a marketplace trying to regulate itself. Perhaps the most serious of these problems is the highly disruptive policy of awarding entitlements to only two participants in the East Coast residual fuel oil market. Fortunately, FEA has accompanied its proposal to exempt residual fuel oils with a regulation designed to reduce this discrimination while at the same time not increasing the average cost of residual fuel oils or any other petroleum product. NOJC members recognize that this solution is politically sound, although we cannot be certain that it will reduce the price discrimination to a tolerable level. We can, however, say with certainty that further reductions in entitlement eligibility can be made if they prove necessary without requiring any continuation of allocation or price controls on residual fuel oils.

There are other problems with continued controls on resid. One is particularly severe for the marketers in NOJC. Our members sell residual fuel oil under contract based upon bids. Few customers know or care that FEA considers them "wholesale purchaser-consumers." The customer wants bids for his business and the customer wants to be supplied by the company which offers the most attractive combination of service, terms and price. But, marketers <u>do</u> know about FEA's regulations and auditors <u>will</u> care about broken "wholesale purchaser-consumer relationships." Suppose I successfully bid for the business of customers other than those which I served in the base period and another marketer successfully bids for some of my base period customers. If that other marketer for any reason fails to meet his commitment, FEA will order me to supply the old customers. But, I may not be able to do that. I may not have adequate storage or timely access to additional supply. So I will be forced to breach my new contract. That is a serious risk that many marketers are <u>very</u> reluctant to take. Of course, we make bids; but, the point is that fewer bids are made than would occur in a decontrolled market, and that means there is less competition and higher prices.

The fact that controls on residual fuel oils frustrate competition while serving no countervailing useful purpose has convinced our members, and now the FEA, that those controls must be ended. Controls will be available on a standby basis if an emergency develops. Personally, I suspect this or some other administration would respond with less reluctance and more efficiency if these controls are ever needed again not only because they have learned some lessons, but also because they will presumably have learned from our experience on this proposal that controls will again be removed when they are again not needed.

My discussion of residual fuel oil decontrol must include consideration of related fuel. It is critical that FEA now move promptly to end controls on No. 2 oils by June 1. Because I also market distillate oils, I am very much aware that fuel oil markets overlap. To decontrol one product while retaining controls upon substitute fuels invites additional disruption. The effects of substitution could, for example, be particularly severe on No. 2 oil in summer when summer peaking electric utilities run near capacity and the price of home heating oil declines. Traditional summer fill practices which are essential to building inventories for winter could be disrupted if the price of residual fuel oil rises even briefly above some ceiling prices on No. 2 oils. If the two oil price could temporarily respond, this problem would be avoided.

Moreover, like resid, No. 2 oil is often sold under one year supply contracts which are renegotiated each spring. If supplier-purchaser relationships are to be decontrolled, it should be done before June 1. Thereafter, frozen relationships will be perpetuated in new contracts and decontrol later in the year will produce less competition over terms. FEA should, therefore, decontrol No. 2 oils before June so as to maximize the competition in renegotiating supplier-purchaser relationships for summer fill as well as for the fall heating season.

Finally, I must emphasize one fundamental problem which the continued freeze on supplier-purchaser relationships is producing for marketers of every product. The abundance of most petroleum products is depressing prices dramatically. But, unlike price competition before controls, today's "price wars" do not involve refiners to any significant extent. Almost all of the price reductions are coming out of jobber and dealer margins and, as a result, some branded and nonbranded independent marketers are in serious financial trouble.

Refiners are not reducing their margins to participate in price competition because the regulations make jobbers and dealers captive customers. Other refiners will not sign supply contracts as long as they have large base period commitments and so marketers cannot change suppliers or even credibly threaten to change suppliers in order to bargain for a lower price. Moreover, class of purchaser rules require uniform prices so that it is impossible to "chip away" at refiner prices in a series of independent small negotiations. Refiners have too much to lose in dropping their price to one customer because they must drop it everywhere to everyone in the same class.

By decontrolling supplier-purchaser relationships, FEA could add a large new element of price competition which will reduce the losses being experienced by independent branded and nonbranded jobbers and dealers. If the government delays even six more months to decontrol supply relationships, there could be a substantial diminution in the capacity of independent marketers to compete. This reduction would contravene the Congressional mandate in Section 4(b)(1)(D) of the Emergency Petroleum Allocation Act which requires FEA to preserve independent branded and nonbranded marketers as a class.

It follows that from a competitive perspective, the Congress should encourage FEA to move expeditiously toward decontrol not only of No. 2 oils but also of gasoline. I understand that in just one week this Committee will be considering other aspects of the relationship

between gasoline marketers and their suppliers. There are questions about those relationships which also need to be resolved promptly. But, for the moment, let me simply emphasize again that a large number of major oil companies are richly benefitting from continued controls on distillate oils and on gasoline because those controls insulate them from price competition.

I honestly believe that most refiners are not seeking to eliminate independent marketers. Several have demonstrated a long-term commitment to serve independent branded and nonbranded marketers. I particularly want to compliment Texaco for its recent offer of very fair five year contracts to all of its jobbers. But at the same time, regardless of the intent of refiners, the fact is that gasoline jobbers and dealers and fuel oil dealers will be in serious financial trouble if controls are not promptly removed from No. 2 oils and from gasoline.

STATEMENT

OF

JOHN A. HILL

DEPUTY ADMINISTRATOR

FEDERAL ENERGY ADMINISTRATION

Before the

SUBCOMMITTEE ON ENERGY AND POWER

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

HOUSE OF REPRESENTATIVES

April 6, 1976

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to testify regarding the FEA proposal to exempt residual fuel oil from continued petroleum allocation and price controls.

Section 455 of the Energy Policy and Conservation Act (EPCA) amended the Emergency Petroleum Allocation Act to specify a revised method of exempting petroleum products from regulation. Under these procedures, the FEA, in order to support an amendment exempting any category of petroleum products from regulation, must make certain findings and express its views regarding the effect of such an action. These have been set forth in a document which has been previously submitted to you. The findings conclude that regulatory controls over residual fuel oil are no longer necessary to meet the objectives of the EPAA, and that residual fuel oil should be exempt from further controls. I would like to summarize briefly the rationale underlying the key findings set out in detail in the report:

1. A substantial worldwide and domestic surplus of residual fuel oil exists;
2. We are currently experiencing relatively low utilization of domestic refining capacity, so that excess capacity exists to meet increased U.S. demand for residual fuel oil;

3. There is a current surplus of foreign refining capacity which is expected to continue for several years, so that the continued availability of imported residual fuel oil would not be threatened by a disappearance of the world surplus of this product, or by an unexpected growth in domestic and foreign demand;
4. Because the current supply of residual fuel oil exceeds demand and because this situation is expected to continue, no effect on the price of residual fuel oil is expected as a result of exemption from regulations, and no effects are expected on any other refined petroleum product;
5. The FEA forecasts a moderate growth in U.S. demand for residual fuel oil but, because of the factors above, supply shortages would not materialize if demand growth exceeds our expectations, and price increases will be held in check by the supply/demand balance.

All of these factors are quantified thoroughly in the document accompanying the proposed amendment, Mr. Chairman, and I will not elaborate on them further at this time.

The FEA submitted this proposed exemption to Congress only after considering a wide variety of comments from parties affected by allocation and price controls. I

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would like now to review those comments briefly to apprise the Committee of the public attitude toward this proposal. All the material to which I refer is a matter of public record retained by the FEA for examination and made available to your staff.

Public Commentary on Controls

The analytical basis for the FEA's recommendation to exempt residual fuel oil from controls is set out in the "Findings and Views Concerning the Exemption of Residual Fuel Oil from the Mandatory Petroleum Allocation and Price Regulations" dated March 29, 1976. However, the FEA considered, in addition to the facts of petroleum supply, demand and price, a wide range of opinion and facts presented by refiners, distributors, consumers and governmental units before proposing to the Congress that residual fuel oil be exempted from regulations.

There were three sources of public comment on the matter available to the FEA which were considered:

1. The written comments and oral testimony received in response to the Notice of Proposed Rulemaking for the Exemption of Residual Fuel Oil.

2. Written comments and oral testimony received in response to the Notice of Opportunity to Comment on the general reevaluation of allocation and price regulations issued as required by Section 454 of the EPCA.

3. Written comments and oral testimony addressing the topic as part of the rulemaking proceedings to modify the Old Oil Allocation Program.

The results of these are summarized briefly below.

<u>Public Comment on the Notice of Proposed Exemption</u>

Public comment on this notice was not extensive, probably in part because there had been a prior opportunity during the reevaluation and entitlements hearings to discuss exemption of products from regulations. Written comments were received from 61 interested parties, of which 18 parties chose to present oral testimony at the public hearing on March 9. These 61 can be categorized as follows:

-- 13 Major Integrated Refiners

-- 7 Large Independent Refiners

-- 13 Small Independent Refiners

-- 2 Refiners' Trade Associations

-- 1 Marketer

-- 7 Independent Marketers' Associations

-- 10 Large Consumers

-- 2 Large Consumers' Associations

-- 2 Consumer Advocacy Groups

-- 3 State Energy Offices

-- 1 Foreign government

Fifty-six respondents supported the exemption from the allocation and price controls. Those favoring controls were:

-- 3 Respondents supporting exemption from allocation controls but retention of price controls;

-- 2 State Energy Offices supporting retention of controls although granting they could be simplified considerably.

The respondents provided a wide variety of comment on related issues. Many preferred to see the exemption of all products at once; several recommended simultaneous exemption of residual fuel oil and No. 2 oils.

Public Comment on the Reevaluation of the Regulations

Section 454 of the EPCA requires that, within 60 days after the Act became law the FEA provide the public an opportunity to comment on the degree to which the FEA regulations have been successful in meeting the objectives of the EPAA, and on the continuing need for the regulations

to meet these objectives. The FEA is to report to Congress on the matter within 120 days, or by April 19, 1976.

In response to this requirement the FEA invited written comment by a notice published in the Federal Register on January 30, 1976, and held hearings on the topic in thirteen cities on February 17, 18 and 19, 1976. In addition to the Notice of Opportunity to Comment in the Federal Register, press releases were issued by the National and the Regional FEA offices, and regional offices contacted almost a thousand public interest and consumer groups, marketers' associations and units of state and local government to advise them of this opportunity.

Written comments were received from 179 interested parties, and 283 oral presentations were made at the hearings. Some of the latter were duplicate presentations made at more than one hearing. As a result, 379 persons, firms and associations were represented. Those can be categorized as:

-- 10 Crude Oil Producers

-- 45 Refiners

-- 48 Wholesale Marketers

-- 43 Retail Marketers

-- 10 Crude Oil Producers' Associations

-- 5 Refiners' Associations

-- 43 Wholesale Marketers' Associations

-- 52 Retail Marketers' Associations

-- 2 Geological Societies

-- 20 Large Consumers

-- 25 Large Consumers' Associations

-- 22 Utilities

-- 3 Consumer Advocacy Groups

-- 37 State and Local Governments

-- 2 Environment and Conservation Groups

-- 2 Universities' Organizations

-- 4 Members of Congress

-- 6 Individuals

Of these 379 parties, 252 directly addressed the issue of whether regulatory controls should be continued. Ninety-one percent of these favored elimination of controls. The number of individuals or organizations cited here as commenting directly on the continued need for controls includes only those who made clear and explicit statements on the topic. Others whose positions might be inferred from their general discussion are not included in these figures.

<u>Comments on the Old Oil Allocation Program</u>

In public comment regarding FEA's proposed modification of the Entitlements Program, the Hearing for which was held on March 2 and 3, a major issue was the method of reducing

disparities among the prices of marketers of residual fuel oil on the East Coast. Specific mention had been made of this matter in the draft of FEA's Preliminary Findings and Views Concerning the Exemption of Residual Fuel Oil. Two alternative methods to resolve the matter were proposed as part of the general revisions of the Entitlements Program and interested parties were asked to comment on whether the second of these alternatives would be inimical to the removal of price controls. Although we can provide no "count" of positions taken on whether controls should continue, it was clear from the responses that the great majority of firms commenting favored the removal of controls and opposed any modification of the Entitlements Program which might create a new rationale for the continuation of controls. Accordingly, the method selected to resolve East Coast residual fuel oil price disparities was designed to avoid a corresponding need for continued product price controls.

Summary

In conclusion, the FEA has considered statements by firms and associations representing what we believe to be the bulk of the residual fuel oil producing, importing and consuming interests. We have found overwhelming support for the removal of allocation and price controls over these fuels.

In conclusion, Mr. Chairman, we believe that the facts of current residual fuel oil supply, demand and price, the existence of a strong competitive market, and the overwhelming weight of public opinion have made it clear that FEA's regulations are no longer necessary for residual fuel oil and that exemption of residual fuel oil will be consistent with the attainment, to the maximum extent possible, of the objectives specified by the Emergency Petroleum Allocation Act. I, therefore, strongly recommend that Congress take no action to disapprove FEA's Amendment of the Mandatory Petroleum Allocation and Price Regulations to exempt residual fuel oil from regulation. I would like to remind the Committee that Congressional acceptance of this exemption means that the controls will be placed on a standby status to be reactivated by the FEA in the event that future conditions change so that regulations are needed to meet the objectives of the EPAA. The FEA will not hesitate to do so if supply, demand or price conditions warrant it.

Mr. Chairman, that concludes my testimony. If the Committee has any questions, I will be pleased to answer them.

REMARKS OF

THE HONORABLE JOHN E. MOSS

BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

APRIL 6, 1976

WITH RESPECT TO DECONTROL OF RESIDUAL FUEL

OIL PRICES

69-327 O - 76 - 6

I wish to thank Chairman Dingell and the other Members of the Subcommittee on Energy and Power for the opportunity to testify today on the regulations submitted to the Congress by the Administration pursuant to the provisions of the Energy Policy and Conservation Act. Your consideration of these proposals is the first major test of the Congressional veto provisions contained in that law. It is also a test of the willingness of Congress to maintain constant vigilance over the impact on consumers of changes in the complex regulatory apparatus administered by the Federal Energy Administration. Today, two major changes in that structure are presented to you and the American people.

The first, and one not subject to EPCA's veto procedure but inextricably bound to the decontrol proposal before you,

SUBSTANTIALLY MODIFIES THE OLD OIL ALLOCATION SYSTEM OR ENTITLEMENTS PROGRAM. YOU ARE BEING ASKED TO TACITLY ACCEPT (1) A DECREASE IN THE ENTITLEMENTS RECEIVED BY DOMESTIC REFINERS FOR EXPENSIVE UPPER-TIER AND IMPORTED OIL USED TO PRODUCE RESIDUAL FUEL OIL MARKETED FOR THE NORTH EAST MARKET AND (2) A GRANT OF LIMITED ENTITLEMENTS BENEFITS TO IMPORTERS OF RESIDUAL FUEL OIL IN THAT SAME REGION.

CONTEMPORANEOUSLY, YOU ARE CONSIDERING A PROPOSAL SUBJECT TO THE EPCA VETO PROCEDURE WHICH EMBODIES THE FOLLOWING MAJOR ELEMENTS (1) DECONTROL OF RESIDUAL FUEL OIL PRICES; (2) ABOLITION OF SUPPLIER/PURCHASER RELATIONSHIPS ESTABLISHED FOR THIS PRODUCT DURING THE EMBARGO PERIOD; AND (3) TRANSFER OF UNRECOUPED COSTS BANKED BY REFINERS BECAUSE OF THEIR INABILITY TO PASS-THROUGH COSTS ASSOCIATED WITH THE PRODUCTION OF RESIDUAL FUEL OIL TO OTHER PRODUCTS.

WITH RESPECT TO THE FIRST PROPOSAL, RELATING TO ENTITLEMENTS CHANGES, ITS MAJOR DISTINGUISHING FEATURE IS COMPLEXITY. FEA ITSELF NOTES THAT THESE CHANGES ARE "VERY COMPLEX AND WILL REQUIRE FURTHER REVIEW AFTER THE EFFECT OF THEIR INTERACTION WITH OTHER FEA REGULATIONS IS FULLY UNDERSTOOD." ONE OF FFA'S GREATEST CONCERNS IS THAT THESE (COMPLEX MODIFICATION OF AN

OF AN ALREADY COMPLICATED PROGRAM) MAY IMPEDE THE DEVELOPMENT OF NEW U.S. REFINERY CAPACITY.

THE ADMINISTRATION IS ASKING THE CONGRESS TO TAKE THIS RISK IN ORDER TO ADDRESS A PERCEIVED PROBLEM IN THE NORTHEAST. THAT PERCEIVED PROBLEM CAN BE STATED IN TWO WORDS--AMERADA-HESS. THIS INDEPENDENT, DOMESTIC REFINER-MARKETER HAS BEEN UNDERCUTTING ITS COMPETITION IN THE NORTHEAST RESIDUAL FUEL OIL MARKET BY AS MUCH AS 5¢ PER GALLON. THIS HAS OBVIOUSLY CAUSED CONCERN AMONG HESS' COMPETITORS WHO ARE GENERALLY IMPORTERS OF RESIDUAL FUEL OIL REFINED ABROAD.

THE PERCEIVED SOURCE OF THIS PERCEIVED PROBLEM HAS BEEN THE ENTITLEMENTS BENEFITS RECEIVED BY HESS BECAUSE IT IS A DOMESTIC REFINER. THOUGH APPARENTLY THIS COMPANY HAS LARGELY PASSED THROUGH THE BENEFITS OF THE SUBSIDY VALUE OF ENTITLEMENT BENEFITS IT HAS RECEIVED AND IS TREATED NO DIFFERENTLY FROM OTHER DOMESTIC REFINERS, YOU ARE BEING ASKED TO MODIFY ITS TREATMENT AND THAT OF OTHER REFINERS SIMILARLY SITUATED IN ORDER TO SUBSIDIZE IMPORTERS.

The changes in the entitlements program presented to the Congress addressing the perceived problem of Hess' price-cutting in the Northeast is an amalgamation of two previous proposals, each of which were rejected by FEA as inequitable. The first of these contemplated a dramatic decrease in the entitlements benefits received by domestic refiners of residual fuel oil for the Northeast. This was rejected because this would have increased consumer costs due to an increase in the imputed blend cost of the crude oil used to produce residual fuel oil.

The other rejected alternative would have granted substantial entitlements benefits to importers of residual fuel oil refined abroad. This strategy was considered as a way of subsidizing imports with the possible result being a decrease of import prices to domestic levels. This was rejected because entitlements given to importers would be purchased by refiners all over the country, the sourse of the subsidy payments. This transfer would increase the blend price of crude oil all across the country.

The proposal which you are considering is a combination of the two rejected strategies but which is asserted to not have the negative effects of its two constituent antecedents. In summary form, the FEA now suggests:

(1) a decrease in entitlements benefits received by domestic refiners with respect to residual fuel oil marketed in the Northeast by 50%, excluding the first 5000 barrels per day (an effective reduction in the entitlements subsidy from \$3.00 to \$1.50 per barrel), and

(2) the extension of entitlement subsidies at a 30% level to importers of foreign residual fuel oil (an effective subsidy of 80-90¢ per barrel).

FEA presumes that the decrease will equal the increase in entitlements benefits and a matching transfer from Hess and similar companies to importers will be effectuated. However, insofar as the transfer is not completely matched, one or the other of the negative impacts associated with the rejected proposals will

BE EXPERIENCED, HIGHER PRICES IN THE NORTHEAST OR HIGHER PRICES IN THE REST OF THE NATION (SEE PROPOSED REGULATIONS 211.67(B)(2) AND SECTION 211.62), I WOULD HESITATE TO ASSURE MY CONSTIUENTS THAT A PERFECT MATCH HAS BEEN GUARANTEED.

ONE OF THE ESSENTIAL ELEMENTS OF FEA'S PROPOSALS IS A DIMINUTION OF ENTITLEMENTS BENEFITS FOR DOMESTIC REFINERS PRODUCING RESIDUAL FUEL OIL IN THE NORTHEAST. THIS, HOWEVER, MAY SUBSTANTIALLY IMPEDE DEVELOPMENT OF NEW U.S. REFINERY CAPACITY. THE NORTHEAST MARKET IS THE MOST IMPORTANT U.S. RESIDUAL FUEL OIL MARKET. NEW REFINERY CAPACITY IS NOW BEING BUILT AND MORE IS PLANNED TO SUPPLY THAT MARKET. THESE REFINERIES ARE BEING BUILT BY INDEPENDENTS EMPLOYING PROCESSES WHICH ARE MORE EFFICIENT IN THE CRACKING OF CRUDE OIL INTO HEAVIER OILS LIKE RESIDUAL FUEL OIL. IF THEY ARE PRESENTED WITH A MARKET IN WHICH THEY ARE PENALIZED WHILE IMPORTERS ARE SUBSIDIZED, POTENTIAL INCREASES IN U.S. REFINERY CAPACITY WILL EVAPORATE. SINCE FEA APPARENTLY SHARES THIS CONCERN, WE SHOULD CONSIDER THIS POSSIBILITY WITH SOME CARE.

To summarize this section of my testimony let me reiterate the potential dangers involved in FEA's proposed modification in the entitlements program. They are:

(1) penalization of a competitive domestic refiner to subsidize importers of foreign residual oil.

(2) potential increase in price of residual oil in the Northeast or the price of all products in other parts of the U.S.

(3) potential disincentive to construction of domestic refinery capacity to supply the Northeast.

In my view, these dangers argue for a continuous and careful monitoring of FEA's entitlements regulations. They also argue for the receipt from FEA of a firm commitment as to its reconsideration of these regulations in the future. Finally, they argue for a firm rejection by this Subcommittee and the Congress of FEA's <u>second</u> major proposal, the deregulation of the price of residual fuel oil.

Analysis by my staff and the staff of the Congressional Budget Office indicates that if residual fuel oil is decontrolled, it will be impossible to judge the impact of the proposed modifications in the entitlements program. If assessment of these changes becomes impossible, intelligent remedial action to address entitlements problems is equally impossible--a grave disservice to the country and an absurd result.

But FEA's second proposal, decontrol of residual fuel oil, is unacceptable and contrary to the public interest for other reasons as well. The Congress has made a determination in the Energy Policy and Conservation Act that consumers need protection against exhorbitant energy prices. But the bottom line for consumers is not the price of crude oil but the price of the energy products they consume. EPCA's controls on crude oil will be unavailing, if product costs do not bear a reasonable relationship to the costs of their crude oil inputs. Further, if such a reasonable cost/price relationship is not maintained, we will exacerbate the present anti-competitive nature of the

INDUSTRY BY REQUIRING INDEPENDENT PRODUCERS TO SELL PRICE-CONTROLLED CRUDE TO INTEGRATED MAJORS SELLING PRODUCTS AT WHATEVER PRICES THE MARKET WILL BEAR. SURELY THIS IS NOT A RESULT THIS CONGRESS CAN ACCEPT.

EVEN FEA IN ITS PROPOSAL INDICATED THAT IF ENTITLEMENTS CHANGES ARE MADE, DECONTROL MIGHT NOT BE REQUIRED.

SECOND, FEA ARGUES THAT LOW IMPORT PRICES WILL ASSURE A REASONABLE RELATIONSHIP BETWEEN CRUDE OIL INPUT COSTS AND PRODUCT PRICES. HOWEVER, FEA IS NOT CERTAIN THAT IMPORT PRICES ARE NOT LOW BECAUSE DOMESTIC PRICES ARE LOW (SEE FINDINGS AND VIEWS, P.64). FURTHER, IT IS OBVIOUS TO ALL THAT LOW IMPORT PRICES ARE FLEETING PHENOMENA WHICH WILL CHANGE AS SOON AS INTERNATIONAL ECONOMIC ACTIVITY QUICKENS (SEE FINDING AND VIEWS, P.27).

FINALLY, ACCORDING TO THE LIBRARY OF CONGRESS STUDY I HAVE SUBMITTED FOR THE RECORD, THE PROXIMITY OF PRESENT DOMESTIC RESIDUAL FUEL OIL PRICES AND INTERNATIONAL PRICES MAY BE THE RESULT OF FEA TRYING TO MAINTAIN PRICE CEILINGS FOR RESIDUAL FUEL OIL WHICH ARE UNREALISTICALLY HIGH.

THE BOTTOM LINE WILL BE AN INCREASE IN CONSUMER PRICES FROM THIS ADMINISTRATION'S DECISION.

LET ME POINT OUT THAT A 1¢ PER GALLON INCREASE IN RESIDUAL FUEL OIL PRICES WILL COST CONSUMERS IN THE NORTHEAST SOME QUARTER OF A BILLION DOLLARS ANNUALLY.

ANOTHER ELEMENT OF FEA'S DECONTROL PROPOSAL INVOLVES THE TRANSFER OF UNRECOUPED COSTS BANKED BY REFINERS BECAUSE OF THEIR INABILITY TO PASS THROUGH COSTS ASSOCIATED WITH THE PRODUCTION OF RESIDUAL FUEL OIL TO OTHER PRODUCTS. SINCE SUCH BANKS WERE CREATED TO INSURE EQUITY IN A REGULATED MARKET, IT IS ESSENTIAL THAT "BANKS" RELATING TO A PARTICULAR PRODUCT SHOULD BE EXTINGUISHED IF THAT PRODUCT IS DECONTROLLED. IF SUCH ACTION IS NOT TAKEN, THE LAWFUL CEILING PRICE OF OTHER PRODUCTS MAY RISE TO THE POINT OF EFFECTIVE DECONTROL.

FEA ASSERTS THAT SUCH AN ACTION THOUGH MERITORIOUS IS IMPOSSIBLE. HOWEVER, IN AN ANALOGOUS SITUATION INVOLVING JET FUEL (SEE SECTION 212.83(c)(1)(iii)), A FRACTION BASED ON DOLLAR VOLUME IN 1975 WAS EMPLOYED TO BREAK OUT PART OF THE GENERAL REFINERY PRODUCT BANK, THE SAME BANK IN WHICH RESIDUAL FUEL OIL

COSTS ARE TO BE FOUND. USING THIS SAME TYPE OF FRACTION, THE FEA SHOULD DIMINISH THAT PART OF A REFINERS BANK ASSOCIATED WITH SALES OF RESIDUAL FUEL OIL.

IN CLOSING, I SUBMIT TO YOU THAT THIS SUBCOMMITTEE AND THE CONGRESS SHOULD REJECT DECONTROL OF RESIDUAL FUEL OIL PRICES. A FAILURE TO DO SO RAISES THE SPECTRE OF SUBSTANTIAL DISMEMBERMENT OF THE LEGISLATION PASSED BY THE CONGRESS TO PROTECT CONSUMERS AGAINST INEQUITABLE PRICES.

STATEMENT OF

WILLIAM H. SEAMAN
VICE PRESIDENT

ON BEHALF OF

THE SOUTHERN CALIFORNIA EDISON COMPANY

BEFORE THE

INTERSTATE AND FOREIGN COMMERCE
SUBCOMMITTEE ON ENERGY AND POWER

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

April 6, 1976

STATEMENT OF SOUTHERN CALIFORNIA EDISON COMPANY
BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
CONGRESS OF THE UNITED STATES

April 6, 1976

Introduction

Southern California Edison Company (Edison) is an investor-owned, California public electric utility, located in PAD-5, serving nearly 8 million people in central and southern California, covering an area of approximately 50,000 square miles including service to defense installations, hospitals, food-processing facilities and other essential services. Edison has approximately 12,520 MW of generating capacity, of which 9,352 MW is oil- and gas-fired, and which has been installed pursuant to certificates of public convenience issued by the California Public Utilities Commission.

In recent years, Edison has experienced a general decline in the availability of natural gas which has resulted in an increased dependency on imported, low sulfur, residual fuel oil. Edison projects that for the year 1976, its total requirement for low sulfur, residual fuel oil will be in excess of 47 million barrels. This requirement for low sulfur fuel oil in 1980 is expected to increase to more than 70 million barrels, and the four major generating agencies in California anticipate a total requirement of more than 160 million barrels for 1980.

In order to comply with the applicable federal, state, and local air quality standards in California, Edison is required to

limit its use of petroleum fuels for power generation to those having a maximum of 5/10 of one percent (0.5%) sulfur content by weight, which severely limits sources of supply. Domestic low sulfur crude oil is not available to be processed in quantities sufficient to meet Edison's increasing requirements necessitating an almost total dependence upon high cost imported crude oil for domestic refining into low sulfur residual fuel oil, and upon direct imports of foreign low sulfur residual fuel oil. Therefore, Edison could be significantly impacted by any program which affects the current mandatory pricing and allocation policies for residual fuel oil and the issuance of entitlements for crude oil or residual oil.

Decontrol of Residual Fuel Oil

During the Arab Oil Embargo of 1973, the Congress passed the Emergency Petroleum Allocation Act (EPAA), designed to provide complete and equitable distribution of such available essential fuels to the consumer. The Nation is not now experiencing petroleum shortages and, within the last year, adequate supplies appear to be available from worldwide sources to meet demands. Therefore, the petroleum supply-and-demand crisis for which the EPAA was passed is no longer the situation. Based upon present and usable supplies, repeal of the residual fuel oil EPAA allocation provisions, through the proposed amendments to 10CFR Part 211, would be prudent at this time, providing that allocation provisions are retained on a standby basis in the event circumstances of future need necessitate their reimposition.

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share of any crude [illegible] increases as th [illegible] e in t [illegible] t.
This point is illust [illegible] n Chart I attach [illegible] ts.

Prior to 1971, average gasoline prices were 58 cents per million BTU higher than low sulfur residual fuel oil prices. However, four years after the initiation of Federal Price controls, first through the Cost of Living Council and the FEA pursuant to the pricing regulation of Part 212, the average gasoline prices were 27 cents per million BTU lower than residual fuel oil prices. This demonstrates that electric utilities and their customers have borne a disproportionate cost of crude oil price increases and, we believe, that if pricing regulations are removed from residual fuel oil, utilities will continue to bear an increasingly disproportionate share of petroleum cost increases. Although these proposed amendments attempt to provide for a specific distribution of increased crude oil costs, as adopted, by imposing limitations upon the distribution of increased costs to other covered products but apparently without any such limitation in favor of residual fuel, they would permit the electric utilities to be subjected to continuing to have to bear a disproportionate share of any cost increases, with a corresponding increase in customers' rates.

Congress recently passed the Energy Policy and Conservation Act (EPCA) which recognizes the continuing necessity of the EPAA and extended its provisions for an additional 40 months. Further, the FEA has recently promulgated amendments to the entitlements program (41FR13899, dated April 1, 1976) designed to provide for competitive pricing between domestic and foreign suppliers of residual fuel oil, while expressly maintaining a cost-competitive edge for

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domestic suppliers. The proposed removal of pricing regulations for residual fuel oil does not appear to be congruent with either the intent of Congress with respect to the EPCA or the FEA's own proposed amendments to the entitlements program. In an artifically-controlled market where one product, out of several, is not regulated, there can be only one result. Unregulated products will receive a disproportionate cost increase and in the specific case of the captive market for residual fue oil, consumers could be made to bear more, if not all, of the crude oil cost increases. This situation will defeat the intent of the EPAA by causing a certain class of consumers, through indirect regulation, to continue to pay a disproportionate amount of crude oil price increases. Thus, it is impractical to exempt residual fuel oil from pricing regulation when crude oil and other products remain controlled.

Edison concurs with the FEA-proposed amendment for the exemption of residual fuel oil from the mandatory allocation regulations of 10CFR Part 211. However, Edison urges that the FEA recognize the possible economic detriment to individual electric consumers and the national economy that would result from removal of pricing regulations on residual fuel oil and, therefore, believes residual fuel oil should not be exempt from the pricing regulations of 10CFR Part 212 until such time as all price controls are totally removed and a true free-market situation returns.

Related Issues

There are several issues of current interest we would like to comment on briefly.

The present worldwide surplus situation could radically and rapidly change. It is for this reason that we believe that the allocation provisions be retained on a standby basis which could be promptly reimposed if a fuel shortage emergency were to re-occur.

It would be possible to establish regional or state by state inventory levels for residual fuel oil which, when reached, would trigger the reimposition of the residual fuel oil allocation regulations. The FEA and FPC currently have, in the forms filed with them, the amount of residual fuel oil stocks held nationwide and by utilities. It is also important to keep the pricing aspects of the regulations separate, such that a utility who "sat back", relying upon the FEA for relief, would not receive any of the price benefits obtained by its more prudent neighbors.

Price controls should not be lifted unless lifted as to all of the petroleum products. If they are, prices may rise whether a shortage exists or not, simply because the oil companies experience less adverse publicity if crude oil cost increases are hidden in another product such as electricity. Hence, rising prices do not appear to be significant criteria for reimposing allocation controls.

A further issue that may develop from the decontrol of residual fuel oil prices is the potential switching to other lower cost price controlled fuel products. With equipment modification most of PAD V utilities could burn distillate-type fuels.

This capacity to switch to distillate-type fuels would be limited by the refiners capability to produce distiallates. We estimate that it would require three years to increase distillate output. Thus, the removal of price controls on residual fuel oil while maintaining price controls on other products could create shortages of distillate-type fuels.

Old Oil Allocation Program (Entitlements)

In addition to our comments on the decontrol of residual fuel oil, I would like to take this opportunity to comment on the FEA's Entitlements Program. Originally, under the Emergency Petroleum Allocation Act of 1973 which was considered before this Committee, the Act requires the equitable distribution of the disproportionate cost burden over all regions and areas of the United States, sectors of the economy, and among all users such that there would be a minimization of economic distortion throught the country. Furthermore, under the EPAA, the Administrator is precluded from implementing regulatory and other actions in a manner that would unduly discriminate against any industry or region of the United States. However, in administering the Old Oil Entitlements Program the FEA has failed to carry out the mandate of the Act. As we have repeatedly pointed out to the FEA, both in formal submissions and orally, residual fuel oil prices have increased disproportionately in comparison with increases in other petroleum products over the last three years. Residual fuel oil prices have consistently been higher on the West Coast than on the East Coast. According to a recent FPC report, the average price of 0.31% to 0.5% sulfur fuel oil

delivered to steam electric generating plants during November, 1975, was $15.66 on the West Coast as compared to $11.72 and $12.35 in New England and the Middle Atlantic Regions of the East Coast. Recently, the FEA, again disregarding price distortions between the East and West Coast, promulgated regulations which would increase the domestic residual fuel oil prices and lowered prices of imported residual fuel oil for the East Coast. We feel these regulations, designed to solve the Carribbean problem, will adversely affect the residual fuel oil consumers elsewhere in the Nation. This adverse effect will come through an increase in their already higher costs for residual fuel oil. Therefore, East Coast residual price reductions would be at the expense of West Coast users of residual fuel oil. Thus, by issuing entitlements for imports of residual fuel oil into PAD I under the new regulations, it will dilute the value of entitlements elsewhere in the country. The effect of this dilution is to cause residual fuel oil consumers elsewhere to subsidize residual fuel oil users in PAD I.

Conclusion

Southern California Edison would, therefore, suggest:

1. Mandatory allocations of residual fuel oil are not now necessary and should be reduced to a standby program.
2. The standby allocation regulations should be reimposed when either the utilities residual fuel oil inventories or the national inventories reach a predesignated level.
3. Mandatory residual price controls should be continued as long as other petroleum products are controlled and crude oil price ceilings are in effect.
4. The mandate of the EPAA, requiring equitable distribution of cost burdens across the country, should be followed by the FEA in administering its Old Oil Entitlements Program.
5. The FEA should do nothing which could increase residual fuel oil prices which are already too high and are thereby imposing an unfair burden upon residual fuel oil purchases and their consumers.

SCE
Table II

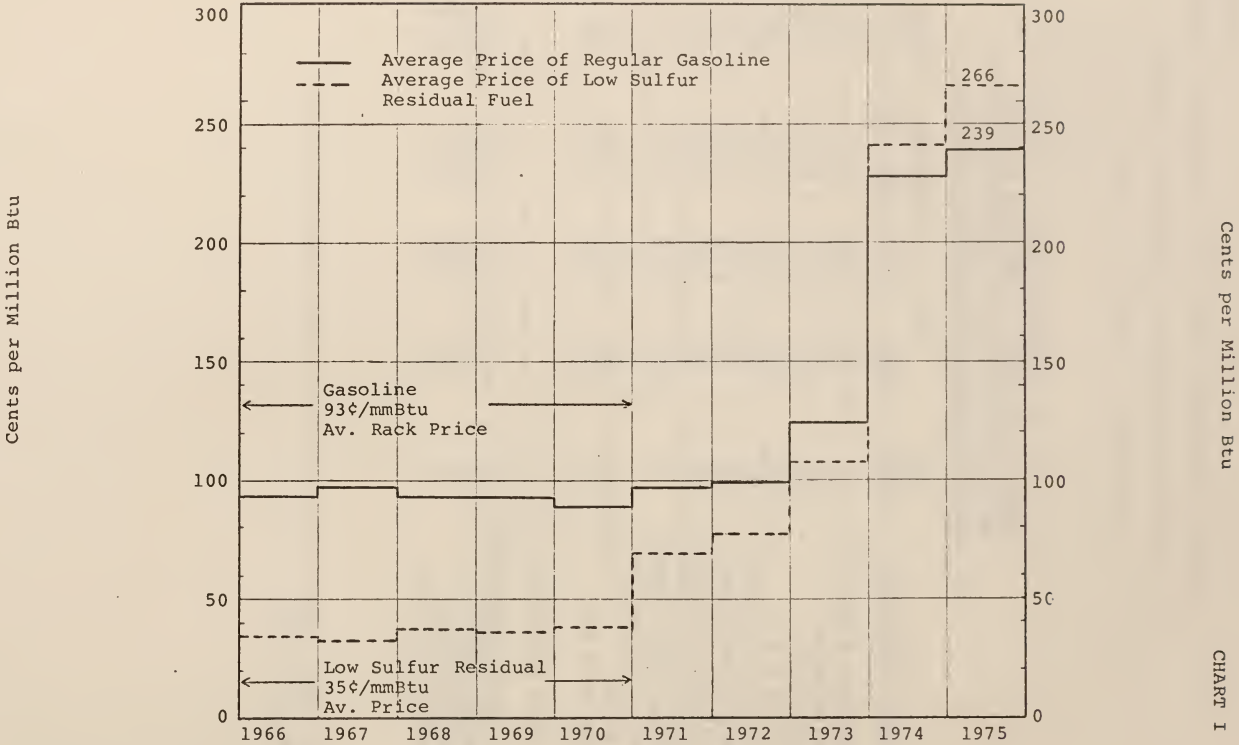
FEA Table III
Index of Increases in Weighted Average
Heavy Fuel Oil Costs to Selected PAD I
and PAD V Electric Utilities in Dollars

PAD I Utilities	May 1973	1973	1974	January-June 1975	July 1975	August 1975
Baltimore G & E	0	.41	7.83	7.87	7.82	7.74
Boston Edison	0	.47	7.64	8.20	7.90	8.11
Con Edison	0	.88	8.72	8.55	8.17	8.20
Florida P & L	0	.53	7.72	8.49	NA[4]	NA
Long Island Light	0	.59	7.33	7.26	7.27	7.23
New England Power	0	.98	8.66	9.10	NA	NA
Northeast Utilities	0	.44	7.89	7.83	7.57	7.32
Philadelphia Elect.	0	.45	7.26	8.26	NA	NA
Potomac Elect. Power	0	.59	6.79	7.11	7.94	7.71
Public Service Elect. & Gas	0	.42	7.66	8.00	NA	NA
Virginia E & P	0	.39	7.20	8.35	NA	NA
PAD V Utilities						
Los Angeles Water Dept.	0	0	4.57	5.50	10.60	11.48
Pacific G & E	0	.41	8.13	11.24	11.03	9.42
San Diego G & E	0	.09	4.98	8.41	8.89	9.19
Southern Cal Edison	0	.52	7.67	10.24	10.58	10.93

May 1973 is the base cost period for each electric utility
May, 1973 - $0

CHART I

COMPARISON OF AVERAGE REGULAR GASOLINE PRICES FROM CALIFORNIA REFINERIES WITH SOUTHERN CALIFORNIA EDISON COMPANY'S AVERAGE PRICE FOR LOW SULFUR RESIDUAL FUEL OIL



January 23, 1976

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

SUITE 300
1700 PENNSYLVANIA AVENUE, N. W
WASHINGTON, D. C. 20006

Statement

of

ARTHUR T. SOULE

on behalf of the

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

before the

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES

Washington, D. C.

April 6, 1976

Mr. Chairman:

Thank you very much for the privilege of appearing before you today. My name is Arthur T. Soule. I am President of Patchogue Oil Terminal Corporation of Brooklyn, New York. Patchogue is an independent deepwater terminal operator serving dealers and consumers in the New York area and on Long Island.

I am appearing today on behalf of the Independent Fuel Terminal Operators Association (IFTOA) in support of the Federal Energy Administration proposal to remove price and allocation controls from residual fuel oil. This proposal was set forth in the Federal Register on April 1, 1976, 41 F.R. 13896-98 (F.R. Doc. 76-9339). The Association is composed of 23 companies which operate deepwater terminals along the East and Gulf Coasts from Maine to Mississippi.*/ None is affiliated with a major oil company. Members market home heating oil (No. 2 fuel), diesel fuel, residual fuel oils (Nos. 4, 5 and 6 fuels) and gasoline at the wholesale and retail level.

I. General Comments

Our Association is very pleased that this proposal is now before the Congress. We have long advocated that price and allocation controls be removed from marketers of petroleum

*/ A list of members and a more detailed description of the Association are attached. (Attachments A and B)

products, and strongly urge that this Committee permit the FEA plan to become effective on June 1, in accordance with the procedures established by the Energy Policy and Conservation Act.

At the outset, we wish to commend the Committee for establishing the procedures embodied in Section 455 of the Act. Under them, the public, the industry, the FEA and the Congress are permitted ample opportunity to review and comment. Under the carefully drafted standards of that section, those who favor exemption of certain products from controls must make a strong case.

We believe that the standards have been met in this case and wish to commend the FEA for the depth of its review and the excellence of its analysis. The Findings and Views*/ which have been presented to this Committee reflect a great deal of effort and represent the best discussion of the residual fuel oil market and the FEA regulations that we have yet seen. As companies who are deeply involved in the East and Gulf Coast fuel oil markets, we believe that the FEA report provides the appropriate factual and analytical basis for the recommendations to the Congress.

We will provide specific comments on FEA's proposal and conclusions in a moment, but believe that some background may be useful to the Committee. As some of you may recall, the FEA first proposed the removal of residual fuel oil from controls in July of 1974. That decontrol plan was based on a hasty,

*/ "Findings and Views Concerning the Exemption of Residual Fuel Oil from the Mandatory Petroleum Allocation and Price Regulations", Federal Energy Administration, March 29, 1976.

superficial analysis, and FEA attempted to secure the approval of the Congress on an expedited basis, before the start of the August recess. Our Association and many others testified in opposition at that time, for two major reasons: first, the analysis was not convincing or supportable, and, second, actual market and competitive conditions did not warrant decontrol so soon after the end of the Arab Embargo.*/ Based on testimony presented at the July 1974 hearings, the FEA decided not to proceed with its plan.

In view of our earlier position, we are pleased to be able to express our strong support for the proposal being considered at today's hearings. As indicated, it is based on sound, supportable analysis; and, as the Congress stated in the Conference Report to accompany S.622, conditions have changed and

> "the potential [exists] for a smooth transition of petroleum markets from a closely regulated state to a largely unregulated status subject to standby pricing and allocation authority."

We are pleased that FEA has agreed. We hope that this Committee will also.

II. Specific Comments

We should like to present comments on the four specific findings and views outlined on p. 13896 of the Federal Register Notice of April 1.

*/ Statement of the Independent Fuel Terminal Operators Association, before the FEA hearings on "Exemption of Residual Fuel Oil", Washington, D. C., July 23, 1974.

1. Supply

We agree with FEA's conclusion that residual fuel is not in short supply and that sufficient refining capacity exists to satisfy projected U. S. demand. The members of our Association are, as the Committee knows, marketers and importers of substantial volumes of No. 6 fuel oil along the U. S. East and Gulf Coasts; we are deeply involved in the U. S., Caribbean and European markets. Based on our experience and involvement we can attest to the fact that there are, and have been for more than 6 months, ample supplies of No. 6 fuel for purchase on a contract or spot basis. Our members own or control nearly 30 million bbls of residual fuel oil storage, and we have not, in recent months, seen our stocks fall below comfortable, normal levels. Although the spot market has been firming in recent weeks, and we have encountered occasional difficulties in obtaining cargoes of low sulfur (.5 of 1% and below) material, we believe that there is sufficient capacity, both here and abroad, to meet all demand, domestic and foreign, in the foreseeable future.

In brief, short of a major disruption such as that which occurred in October 1973, there will be no shortages of this product. Thus the removal of controls creates no risk of shortage, particularly since those controls will remain on a stand-by basis for immediate reimposition in case of supply emergency.

2. Adverse Impact on Supply of Other Products

We agree with FEA's conclusion that removal of controls on residual fuel oil would not have an adverse impact on the supply of any other oil or refined product, including No. 2 fuel oil or middle distillate fuels. As the Committee is aware, what happens to No. 6 fuel can affect No. 2 fuel oil, because some consumers can shift usage from one to the other by direct, full substitution or by changing the blend between fuels. This issue was carefully reviewed by our Association and at the recent FEA hearings.*/ Based on our experience in the marketing of both fuel oils and a review of the hearing record, we agree with FEA's conclusion (on pp. 48-49 of the Findings and Views) that removal of controls on residual fuel oil will have no adverse impact on the supply or price of distillate. However, as we stated at the FEA hearings we believe that middle distillate de-control is also good for the marketer and the consumer and hope that FEA will proceed expeditiously with action on this product as well.

In sum, we concur in FEA's second finding, relating to the absence of an adverse impact on other oils or products. In addition, in order to insure the most favorable competitive conditions for marketers and consumers of all fuel oils we hope that middle distillates will also be removed from controls in the near future.

*/ See in particular Attachment C of Statement presented by our Association at FEA Hearings on March 9, 1976.

3. Competition

We agree with FEA's conclusion that competition and market forces are adequate to protect consumers and that there will be more competition after decontrol. As active competitors in the residual fuel oil market*/ --among ourselves and with other marketers and refiners--we have long maintained that current controls are limiting the full play of competitive forces. It is our firm conviction that if controls are lifted and if marketers such as ourselves can shop around for the best terms and the lowest price, the consumer will clearly benefit. As FEA states on p. 13896 of the Federal Register Notice:

> "The exemption would permit purchasers (including consumers) to seek the lowest cost supplier by freely using competitive bids without regard to fixed supplier/purchaser relationships, thereby exerting downward pressure on existing market prices and providing incentives to enhance marketing services."

We can cite case after case in recent months where the continuation of controls has prevented consumers from shopping around for the lowest cost and best service. Further, many residual fuel regulations are being honored more in the breach--that is they are being ignored--by marketers, consumers and Federal and state governments. This is particularly true in the case of competitive bidding; despite the fact that bidding is prohibited under FEA

*/ The members of our Association are basically the "non-refiner independent marketers" discussed on pp. 97-102 of FEA's Findings and Views.

regulations and rulings,*/ the FEA is choosing to ignore violations of these rules and permits open bidding. Many of our members now face the anomaly of seeing base period customers bid away from them, in violation of the rules, but still being required, by those same rules, to keep residual fuel on hand in case the new supplier cannot fulfill the contract.

In brief, there is chaos, confusion and outright violation of the rules. As FEA states in its finding, this is leading to a deterioration of competition, particularly for companies who attempt to abide by the rules.

We might add that it is essential--as FEA has proposed--that controls be removed from all companies, at all levels of the residual fuel oil market--for refiners and independents alike and for all sales beyond the crude oil level. If controls were to be removed from independents and not integrated refiners, serious anti-competitive distortions would still exist.

FEA states, "Market anamolies on the East Coast detrimental to some marketers have existed due to the previous operation of the entitlements program".**/ This refers of course to the serious anti-competitive impact of the large financial benefits granted to the Amerada Hess Corporation. As the East Coast independent marketers most adversely affected, we believe the FEA has arrived at a balanced solution to the problem, as

*/ Ruling 1974-19, June 14, 1974, 39 F.R. 22133.

**/ 41 F.R. 13896.

announced on March 29.*/ We agree with FEA's conclusion, set forth on p. 13896 of the Federal Register Notice, that:

> "The amendments are expected to enhance competition in the East Coast market by reducing the amount of the disadvantage suffered by some marketers and to prevent any marketers from obtaining undue economic advantage as a result of decontrol."

This last point is critical. With the "Hess solution" now in place, decontrol can proceed. The product entitlement feature of the solution provides assurance to the Congress and the consuming public that there will be no significant price increases for residual fuel oil; in fact the price benefits resulting from entitlements to residual fuel oil importers such as ourselves, combined with the full supplies anticipated in the months and years ahead, guarantee that there will be fierce competition--on the basis of price--for the consumers' business. In fact, in the week since the entitlements program was announced, there has been a marked increase in price competition in the New York area.

In sum, now that an effective solution to the East Coast competitive problem is in place, prompt and complete decontrol of residual fuel oil will strengthen market forces and greatly assist the competitive viability of all marketers, particularly independents such as ourselves.

*/ "Amendments to Old Oil Allocation Program", 41 F.R. 13899-906, April 1, 1976 (F.R. Doc. 76-9337).

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4. Price

We agree with FEA that exemption of residual fuel oil will not result in inequitable prices for any class of residual fuel oil or other product user.

We also agree with FEA's conclusion that "aggregate prices for residual fuel oil will remain unchanged by the exemption itself. Prices can, however, be expected to rise over time as the result of increased domestic and foreign crude costs". These are critical points. They are honestly and accurately stated. They bear repeating: residual fuel oil prices may rise in the future, but decontrol will have nothing to do with it. And prices could well increase to a greater extent if controls are maintained. FEA's Findings and Views put the situation accurately:

> "If price and allocation controls are retained, to the extent they interfere with normal competition, the anticipated increase in demand will be more likely to cause residual fuel oil prices to rise to maximum lawful levels. If residual fuel oil is exempted from controls, however, the additional competition thereby permitted to operate will likely constrain prices somewhat below the levels they would otherwise be allowed to attain (p. 26).
>
> Therefore, it is anticipated that competition and market forces combined will continue to exert downward pressure on prices and will prevent price increases from occurring solely as a result of removal of controls (p. 94)."

In other words, present price rules exercise no restraint on the upward movement of prices. In fact, because they create competitive distortions and force marketers to pay added costs,

price controls have the effect of keeping prices somewhat higher than they otherwise would be.

FEA is correct in its analysis of current market conditions. All of our members are pricing far below their allowable ceilings and most appear to have accumulated substantial volumes of "banked" costs, which is a further indication that full cost recoupment and full pricing are not being realized from the marketplace.

Residual fuel oil prices were particularly low during 1975, reflecting an excess of supply and very low demand. With the economic recovery beginning to take hold in the United States, Europe and Japan, and crude costs expected to rise in the U. S. and the rest of the world, it is obvious that heavy fuel prices will go up. But again, this will have nothing to do with decontrol.

In sum, we agree with FEA's conclusion on price. We realize that this is a critical issue in the Committee's consideration of FEA's exemption proposal. We, therefore, wish to assure you that, based on our experience as marketers of large quantities of residual fuel oil for many years, we believe the FEA has handled the matter openly, persuasively and accurately.

III. Conclusion

In conclusion, the Independent Fuel Terminal Operators Association agrees with FEA's findings and conclusions and urges that this Committee and the Congress permit the plan for removal

of residual fuel oil from allocation and price controls to become effective on June 1. The plan meets the standards established by the Congress in Section 455 of the Energy Policy and Conservation Act and will benefit consumers and marketers of residual fuel oil.

Thank you very much.

Attachment A

MEMBERS

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

Belcher Oil Company
Miami, Florida

Blue Ridge Fuel Company
New York, New York

Bray Terminals, Inc.
Albany, New York

Burns Bros., Inc.
Brooklyn, New York

Cirillo Brothers Terminals, Inc.
Bronx, New York

Colonial Oil Company
Jacksonville, Florida

Colonial Oil Industries, Inc.
Savannah, Georgia

Deepwater Oil Terminal
Quincy, Massachusetts

Ergon, Inc.
Jackson, Mississippi

Gibbs Oil Company
Revere, Massachusetts

Howard Oil Company, Inc.
Maspeth, New York

Meenan Oil Co., Inc.
New York, New York

Metropolitan Petroleum Company
New York, New York

Northeast Petroleum Industries, Inc.
Chelsea, Massachusetts

Northville Industries Corp.
Melville, New York

Patchogue Oil Terminal Corp.
Brooklyn, New York

Seaboard Enterprises, Inc.
Boston, Massachusetts

Southland Oil Company
Savannah, Georgia

Swann Oil, Inc.
Bala Cynwyd, Pennsylvania

C. H. Sprague & Son Company
Boston, Massachusetts

Steuart Petroleum Company
Piney Point, Maryland

Webber Tanks, Inc.
Bucksport, Maine

Wyatt, Inc.
New Haven, Connecticut

The 23 companies listed above own and control terminals capable of receiving ocean-going tankers. None is affiliated with a major oil company. Members of the Association are independent marketers of No. 2 fuel oil, No. 6 fuel oil, gasoline and other petroleum products.

They distribute 40% of the No. 2 fuel oil consumed in New England and 25% of the No. 2 fuel oil consumed along the East and Gulf Coasts. They distribute nearly 60% of the residual fuel oil burned by non-utility consumers in New England and nearly 50% in the Middle Atlantic states.

The 23 companies own and control nearly 20 million barrels of No. 2 fuel oil storage capacity and nearly 30 million barrels of residual fuel oil storage capacity.

Attachment B

Descripton of IFTOA Operations and Facilities

Members of the Association operate 60 deepwater terminals and 47 barge terminals with a total storage capacity of over 53 million barrels. The geographic distribution of those facilities is as follows:

	No. of terminal operators	No. of terminals deepwater	barge	Total Storage Capacity*/
New England	7	22	6	11,789,000 bbls.
Middle Atlantic (New York - Maryland)	11	24	32	32,370,000
South Atlantic and Gulf Coast	5	14	9	8,854,000
Totals:	23	60	47	53,013,000

Most of our members have been in the terminal business for generations. Some companies began in the ice business, got into the coal business and then became fuel oil marketers as that energy source became dominant in our marketing areas. We operate, as you can see from the chart above, a number of large terminals which are capable of receiving ocean-going tankers. The typical terminal facility, as the Panel knows, consists of docks, unloading facilities, pipelines, storage tanks and "racks", the platform from which oil is pumped from the tanks into fuel oil trucks for transport to the consumer. Our terminals are located in or near the areas of consumption of fuel oil and are an integral part of the complex distribution system that carries bulk petroleum fuels from the refinery to the ultimate consumer.

We purchase from refiners--either in the United States or abroad--and bring the material by tanker to our facilities, where it is unloaded and stored in our large tanks. The oil is then pumped into barges or trucks owned by ourselves or other companies and transported to the ultimate consumer--the home, factory apartment, school or hospital. As independent companies, we provide direct competition to the major oil companies and provide an alternative supply source for thousands of independent retail dealers

*/ The product breakdown is as follows:

No. 2 fuel oil	19.9	million	bbls.
Residual fuel	28.7	"	"
Other products	4.4	"	"

and millions of consumers who would otherwise be forced to rely solely on the large companies. We handle about 25% of the No. 2 fuel oil and nearly 50% of the non-utility residual fuel oil shipped to the East Coast. In New England our members market 40% of the No. 2 fuel oil and nearly 60% of the non-utility residual oil.*/

*/ For a more detailed analysis of the independent position in the East Coast residual fuel oil market, see statement of John G. Buckley on behalf of the Independent Fuel Terminal Operators Association before the FEA hearing on "Exemption of Residual Fuel Oil", Washington, D. C., July 23, 1974.

STATEMENT OF

STEPHEN J. SWEENEY, DIRECTOR OF PUBLIC AFFAIRS

BOSTON EDISON COMPANY

BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER OF THE HOUSE

INTERSTATE AND FOREIGN COMMERCE COMMITTEE

ON

APRIL 6, 1976

My name is Stephen J. Sweeney and I am Director of Public Affairs for Boston Edison Company, a public utility which provides electric service to approximately two million people in the metropolitan Boston area. We appreciate your invitation to testify before this Subcommittee on the exemption of residual fuel oil from the Mandatory Petroleum Allocation and Price Regulations. As a user of large amounts of fuel oil, we have a vital interest in its availability and price. We welcome the opportunity to express our views on the Federal Energy Administration's proposal.

The dependence of our region on imported fuel oil resulted in disastrous economic consequences to our customers concomitant with the oil embargo of late 1973. Since that time, we have appeared before various Congressional committees and federal agencies on no less than eight occasions in an attempt to seek much needed relief for our customers. We have supported a National Energy Policy which would recognize the energy crisis as a national problem and provide equality for all citizens. We watched with dismay the failure of our federal government to recognize the inequities that clearly existed. Even when those inequities were specifically defined, we watched with wonder and disappointment, the lack of positive and substantive action to relieve an entire section of the nation from an undeserved and

unnecessary burden. We have not surrendered what we believe to be a fundamental obligation to our customers on this matter -- nor will we until reasonable equality is achieved.

We applaud your concern and action in holding this hearing in order to obtain information required to render informed decisions. We only hope the Subcommittee will be a vehicle for moving the nation forward in a direction that is in the best interest of all its citizens.

The consumers who buy electricity from Boston Edison in effect purchased 14 million barrels of residual fuel oil in 1975 at a cost of $168 million. In 1976, we estimate that 15½ million barrels of oil will be consumed. While it is difficult for a purchaser to identify the origin of residual oil, we believe that in 1975, 80% of this oil was imported from refineries outside the United States. In 1976, we estimate that 85% of the oil we use for generating electricity will be imported.

Boston Edison, in testimony at the Federal Energy Administration's hearings on proposed amendments to the entitlements program, supported the removal of mandatory price and allocation controls from residual fuel oil. We agree that there is currently a large supply of fuel oil and that the present regulations are, if anything, causing higher prices than those which would be in effect without them. We continue to believe that in normal times, the marketplace provides the best mechanism for fair and equitable distribution and pricing for all goods, including residual fuel oil. We still feel that the removal of controls is not inconsistent with the granting of crude oil entitlements to importers of residual oil. Since Congress has already decided to have continued regulation of crude oil prices, we view the old crude oil as a national resource whose benefits should be distributed equitably to all regions of the country. We are heartened by the Federal Energy Adminis-

tration's recognition of our problem in its decision to grant a 30% entitlement to importers of residual oil. We testified in favor of a full 100% entitlement in order to achieve national price parity and offered that considerable equality could be achieved with 75% entitlement. So, while heartened by the action of the Federal Energy Administration, we are disappointed with the magnitude of the entitlement. However, even at the lower level, the proposed change in regulations might save our customers as much as $11.5 million in 1976. We feel that the market for residual oil is competitive and that competition will cause the entitlement benefits to be passed along to us in lower fuel prices. We, of course, are obligated by law to pass all fuel savings along to our customers.

We understand from the Subcommittee's staff that the following questions are of interest to the Subcommittee:

1. At present there is an abundant world supply of residual fuel oil. In case of shortages of oil in 1977 or beyond, due to economic recovery here and abroad, would it be necessary to reimpose price and allocation controls?

2. What criteria should be used in deciding if and when standby control regulations should be implemented?

3. Are both allocation and price controls necessary? Based on our experience with the present controls, what suggestions do we have for the nature of future standby controls?

4. Should the price of distillate fuel oil drop below that of residual, can and would we use distillate fuel for electric generation?

The issue of the future supply of oil is very important to us and our customers. Given New England's lack of either oil production or refining capability, we will continue to depend on imported residual oil for generation of electricity over the next several years. Unless oil is discovered off our coast, this dependency is likely to continue until the primary source of our electric power generation is accomplished with technologies using indigenous energy sources (nuclear and coal) and those sources still in the development stage (solar, wind, fusion, etc.). Given this situation, one of the unfortunate consequences of the history of residual oil price and allocation controls has been to increase the disparity of residual oil prices in different sections of the country. A good deal of this disparity was caused by the entitlements program which, in effect, required our region to bear the brunt of world market price increases, and programs which put duties of various sorts on petroleum imports in an attempt to increase domestic production. We believe that our customers would have been better served by having no price and allocation controls on residual oil after the oil embargo ended. Accordingly, we strongly support the market mechanism as the best means of allocation and price determination. Market forces are extremely strong and make themselves felt even with very comprehensive regulation. If the world supply of residual oil decreases relative to its demand, an ensuing price increase is inevitable with or without controls. In addition, controls have their own costs in terms of added administration and less freedom for individual consumers in their purchasing and consumption decisions. Our concern is that under the past and current regulations on crude oil, the higher price was not equitably distributed across the nation but fell on the citizens of New England. The effect on the economy and people of our region has been disastrous. In retrospect, it appears that we would have fared better in the marketplace rather than with the type of regulation imposed in the past.

We would not favor reimplementation of mandatory allocation and price controls so long as the market for residual oil was operating in an orderly fashion. Certainly another embargo, or a war in the Mid-East, would be events which would clearly require the implementation of some sort of controls. Any event which would be likely to cause a disruption in the market would also qualify. In general, we believe that allocation and price controls should be imposed only in situations where there is no question that this is an appropriate response. In any other case, there is great difficulty in determining exactly what variables to examine in order to make a decision as to when and if controls should be reinstituted. For example, if there are substantive reasons behind price rises, then controls as previously applied will not address these. If price levels are mandated at levels far from market levels, both shortages and black markets are bound to appear. Our experiences with price controls over the last thirty years confirm these observations. In addition, whenever controls are implemented, bureaucratic structures develop which have inherent survival power. The controls seem to last until long after they are necessary or appropriate. Therefore, we believe mandatory price and allocation regulations should be thought of as an extreme remedy to an extreme emergency.

If an emergency of sufficient magnitude occurs, what kind of regulation is necessary? In the case of a wholesale disruption of the marketplace, it would seem that any emergency regulations should be directed toward protecting the specific interests of the public, while averting panic and providing and restoring conditions under which the market can continue to operate. In case of severe and sudden supply shortages, we believe that both allocation and price controls are necessary. In a supply shortage, it is necessary to

specify priorities of users, such as hospitals, public utilities, etc. These users would pay higher prices due to severely constricted supply, since the users would have little choice about the amount they consume. They would have to absorb the higher costs and pass them on to everyone. Specific price controls for priority users, at least, are a necessary part of an emergency regulation program.

We would hope that the experience we have had with previous allocation and price controls would be a useful guide toward determining the nature of such controls, should we need them in the future. As an electric utility which is a member of a regional power pool, we would suggest that future emergency allocations of residual fuel oil should recognize a company's participation in pool activity rather than just the requirements of its own customers. The overall economy of power pool operations should be maintained. The reason for this is that the operation of the generators which consume the oil is under the control of the power pool. Therefore, there is considerable variation in the monthly fuel oil needs of individual utilities, while the needs for the power pool are fairly predictable. We experienced some difficulty due to this situation under the allocation regulations during the embargo.

Finally, with regard to substituting distillates for residual oil, we believe that if a sufficient price differential were sustained for a long enough period of time, we would consider burning distillates. There is very little technical difficulty in converting from #6 to #2 oil assuming the existing fuel pumps can handle #2 oil. Distillate (or home heating oil) does not have as high a heating value as residual oil. Residual oil would need to be priced approximately 5.5% higher than #2 oil before a break-even point occurs. As of April 1, we could have obtained #2 oil

on a contract cargo basis at a price range of \$12.85/bbl to \$13.75/bbl. Due to its lower heating value, the comparable price on a heat basis, to residual is \$13.55/bbl to \$14.48/bbl. These prices should be compared to low sulphur residual. Currently for .5% sulphur residual oil we are paying \$11.28/bbl to \$12.74/bbl. Therefore, currently there is no advantage to burning #2 oil. However, even if the economics justified the burning of #2 oil, unless the price differentials were considerable and appeared to be long lasting, we would probably still not convert to #2 oil because of logistic and supply problems. As long as controls are in place for #2 oil, we cannot be assured of an adequate supply. In case the controls were removed from #2 oil, the entry of utilities into the distillate market would raise the price. Because of these factors, one can estimate that at the current price levels, disparities of something like a dollar a barrel or more, together with a future outlook of the differentials continuing for several months, would be necessary in order to make changing fuels reasonable.

In addition, there is some doubt as to the capability of existing fuel pumps to handle the #2 oil. This matter is presently under study to determine if modifications would be necessary and, if so, how extensive they would be.

In addition, we would be seriously concerned about the economic impact on our customers should the electric utility industry become a large user of distillate fuel oil. The uncertainty of the impact on the price of home heating oil and gasoline must be considered. We have been vigorously working to reduce the burden of fuel costs to our customers and would be reluctant to take a step which, on one hand, may appear to be beneficial but, on the other hand, may ultimately penalize them. Clearly, the potential impact of such a step

would have to be fully known prior to actual implementation. Technically, it can be done -- economically, it may not be in the best interests of the consumer.

In addition to our efforts to attain parity in fuel oil prices for our customers, we intend to continue to take those steps necessary to reduce our dependence on oil as a source of energy. We believe this to be consistent with Project Independence and a sound National Energy Policy.

I hope this information is useful in your deliberations. Thank you again for the opportunity to present it.

Presented by: Stephen J. Sweeney
Director, Public Affairs
BOSTON EDISON COMPANY
April 6, 1976

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JOHN S. EDWARDS
DEPUTY DIRECTOR

Comments of the New York State
Emergency Fuel Office to the
Federal Energy Administration
Executive Communications Room 3309,
Federal Energy Administration Box FY
Washington, D.C. 20461 March 2, 1976
Re: Amendments to Entitlements Program

The entitlements program is one of the most complex and confusing programs imaginable. The time span between the publication of notice of hearing and the actual hearing itself may be sufficient in law but is insufficient in fact.

The current situation relating to residual fuel consumed in Petroleum Allocation District I (PAD I) is most unfair. Only one refiner, Amerada Hess, serving the East Coast with product from the Carribean is eligible to receive entitlements. Amerada Hess is unique in that it purchases foreign crude in the Carribean for processing in its domestic refinery located in the Virgin Islands which is under the jurisdiction of Region II of the Federal Energy Administration (FEA). All other oil suppliers obtaining residual oil from the Carribean, import the product in its refined form from foreign refineries located in the Carribean area. Therefore, Amerada Hess receives payments in the form of entitlements from other oil companies. Entitlements are only relevant as to crude oil i.e. no entitlements are received for finished product. Therefore, Hess is presently receiving $3.07 per barrel in entitlements through the Entitlements Program. Except for small differences in the costs of crude oil and transportation, Amerada Hess is thereby able to undersell its competitors by this $3.07 per barrel.

We agree with the FEA that this imbalance must be corrected.

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With reference to the two alternatives suggested by the FEA, the only assurance the State of New York has is that the price of Hess product will increase.

The State of New York is firmly opposed to the first alternative proposed. This first alternative takes some of the value of the entitlements away from Hess by reducing the entitlement value for domestic refiners processing foreign crude oil to produce residual oils. The reduction would be to a level as low as 25% of current value. Thus there would be no change in the price of residual fuel from foreign refineries. The price of residual fuel from domestic refineries would rise inasmuch as it would reflect the lower value of the entitlement. Such changes would force the cost of residual fuel to rise at the retail level throughout PAD I.

The price of residential fuel in the State of New York already exceeds the national average. According to the latest Bureau of Labor Statistics (BLS) information, during November and December 1975, residual oil cargo shipments to resellers in the mid-atlantic region, which includes New York and other PAD I states, were more than three cents per gallon <u>above</u> the national average. Furthermore, the present supply and distribution system force New York State industry, in many instances, to consume heavy oils in processes for which their competition, located in other states, use natural gas. Industrial purchasers in this state are currently paying, on a BTU basis, 102 percent more for #6 oil than the nationwide average price of natural gas. In addition, maintenance expenditures for heavy oil heating systems far exceed similar costs for natural gas fired units.

Industries are unwilling to locate or expand in states where energy prices are relatively high and expected to go higher. According to a Federal Regulatory Commission Report,[1] natural gas and electric rates in New York State are nearly twice the national average while coal is half again as expensive. At the same time, the 1975 annual average 10.1 percent unemployment rate for our State is

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1. FRC, <u>News Release</u> 11/22/74

[illegible] percent higher than the 8.5 percent U. S. rate. Since 1968, the Empire State manufacturing employment level has decreased to 1.4 million, a loss of over [illegible],000 jobs. In addition, last year alone, high energy prices and shortages were responsible for layoffs at 39 firms amounting to nearly 20,000 workers.

As we stated in our testimony of February 17, 1976: "Our country is presently most concerned, and rightfully so, lest we create boom towns to be followed by ghost towns in areas of unsurpassed and unmarred beauty in order to solve our energy needs. Should we not also continue to be concerned lest we create ghost cities and ghost states? The factories, the schools, the hospitals and all other necessary services already exist and to a very large extent are bought and paid for. Does it make economic or energy sense to build elsewhere while we allow that which already exists to decay and rot? An industrial plant does not exist in a vacuum, it needs people to run it and they need homes, hospitals and schools. 'An equitable and proportionate distribution of costs' must be used to avoid such wasteful and unnecessary duplications." It is for these reasons that we strongly oppose the first alternative and urge the FEA to take all steps necessary to equalize BTU costs so that all sectors of the country can compete on equal footing.

The position of the State of New York, as set forth in written and oral testimony at various times, as well as at the "think tank" session on contingency plans on February 5, 1976 at Region II, is that all energy resources must be taken into account. Energy planning cannot be done "piecemeal." If specific additional authority is needed by the FEA to do the job then it is FEA's responsibility to seek that authority from Congress. A contingency plan geared to a scenario of a prolonged oil embargo which, for instance, calls for a four day week cannot be implemented by just requiring the schools, hospitals, industries, etc., heating with

oil to go on four days. Any contingency plan must speak to all energy resources. Every fuel is a potential alternate for every other fuel. We again urge the FEA to secure the authority necessary to get the job done.

The second alternative takes the opposite approach and would grant entitlements to importers of finished residual fuel oil thereby making [illegible] to that of domestic refiners. This would broaden the volume [illegible] which would be eligible for entitlements. It would thereby decrease the value of each entitlement but there is no concrete mechanism proposed which would insure that this price decrease [illegible] fully passed on to the consumer.

The [illegible] that is imported [illegible] will likely [illegible]. Statistically this conclusion is possible but, in view of the [illegible] operative losses shifted [illegible] same importers, price reduction may [illegible]. If domestic refiners of residual fuel from foreign crude oil receive entitlements which are of lower value than heretofore, it would raise the refinery feedstock costs. This would result in higher passthroughs and increased not decreased retail prices from domestic refineries. Since 76%[2] of PAD I residual fuels are secured from foreign sources, this alternative leaves a lot to chance as to which way the overall price change would move in the State of New York.

The State of New York submits that neither proposal presently submitted should be adopted in this time of economic recession and inflation. We most strongly urge that the FEA "go back to the drawing board", schedule another hearing with sufficient notice to enable the States and other interested parties to be able to maximize their input. It might be wise, though unusual, in connection with a program of such complexity to suggest to interested parties that they submit their own plans then circulate these plans among those who have expressed their interest by requesting the plans or submitting a plan of their own and thereafter holding a hearing as to which of the plans is not

2. Mineral Industry Surveys, "PAD Districts Supply/Demand," U.S. Department of Interior, Bureau of Mines, Table 2, October 10, 1975

only workable, but will accomplish the purpose desired.

Balancing the cost of residual oil among refiners will only serve to continue the price disparity between the East Coast energy supply which is oil, and the energy supply of states, which rely more heavily on products other than petroleum. Unless there is an equalization of the cost of BTUs the employment problems of the Northeast will continue to exacerbated. It is suggested, therefore, that in its consideration of revision of the Entitlement Program to deal with whatever inequities may exist in the residual oil market place, let FEA also give consideration to the following issues:

1. The disproportionately high energy costs now experienced by manufacturers and utilities on the East Coast compared with other regions of the country.

2. The overall profit picture of refiners throughout their entire product line.

In the event that the FEA chooses not to go back to Congress to implement the suggestions made here then, in such unfortunate circumstances, we recommend that the following be considered by FEA:

3. Subsidizing higher energy costs on the East Coast for residual oil by broadening the Entitlement Program and shifting higher prices to gasoline which burden would be borne by the entire country.

While we must continue to be concerned about the availability of products, we must also be aware of other problems including economic imbalances. Favorable consideration of the suggestions of the State of New York would assist the Northeast in reaching stable employment and economic recovery more in line with the national average. It would share the burden of high energy costs with other regions of the country that are now receiving energy at costs subsidized by the policy of the Federal government.

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JOHN S. EDWARDS
DEPUTY DIRECTOR

Comments of the New York State
Emergency Fuel Office submitted
to the Federal Energy Administration
March 9, 1976 Washington, D. C.
Re: Proposed Exemption From Mandatory
Petroleum Allocation and Price
Regulations

Gentlepeople:

I am pleased to have the opportunity to speak to you today on behalf of the Governor of the State of New York and all agencies in the executive branch of the State government.

I am John S. Edwards, Deputy Director of the New York State Emergency Fuel Office which is the office certified by the Federal Energy Administration (FEA) as the State Office of Petroleum Allocation.

The Federal Energy Administration (FEA) in the announcement of this hearing published in the Federal Register of February 17, 1976 states in part on page 7122 that:

> "Because supplies of crude oil and refined petroleum products have generally been sufficient since the end of the 1973 oil embargo,..., it has been apparent for some time that the complex regulatory program created for the embargo shortage period may no longer be necessary..."

The State of New York agrees wholeheartedly that a "complex regulatory program" is no longer necessary. Indeed we have long questioned whether any practical program need be so complex.

Moreover, what FEA now terms "sufficient" and which the regulations refer to as "surplus" may disappear very quickly once our economy recovers. We also must not lose sight of the fact that the alternate fuels to our dwindling supplies of

natural gas are petroleum products. We suggest any significant "surplus" should be directed towards our strategic reserve plan called for by the Energy Policy and Conservation Act of 1975 (EPCA75).

We must use the regulations to conserve, to buy time until alternate energy resources are available.

However, the FEA goes on to propose the exemption of residual fuel oil, i.e., Nos. 4, 5 and 6, Bunker C, No. 4-D diesel and Navy Special, from the Mandatory Petroleum Allocation and Price Regulations.

The State of New York firmly opposes such exemption.

Is there no other way to deal with overly complex regulations except to abolish them? Abolition of the mandatory regulation program is, in fact, what you propose to do. In the past you have suggested various methods to abolish the allocation program either in toto or piecemeal. Now you again suggest piecemeal abolition. If we are certain of nothing else, we are certain that if residual fuel oil is exempted, other petroleum products will not be far behind and that will be the end of the mandatory program.

If you can conceive of deregulating residual fuel oil which is only used for such essential purposes as space and industrial process heating and electric generation rather than pleasure and upon which the East Coast is so heavily dependant then we must raise questions as to motivation.

As the psychiatrist said to his patient: "Just because your doctor says you're not paranoid doesn't mean they are not out to get you."

At a time when the unemployment rate declined nationally from 8.3% in December to 7.8% in January, the joblessness in the State of New York increased from 10.3% to 11.1% in the same period. This represents over 830,000 job seeking people.[1] With unemployment disproportionately heavy in New York State, higher prices of residual fuels, which is an inevitable result of decontrol, can only exacerbate the situation.

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1. New York State Department of Labor, Division of Research and Statistics, February 27, 1976, RS 201.1 Report.

The FEA publishes its Preliminary Findings on page 7124. Thereon, Finding (4) states that: "It is not anticipated that there will be any adverse state or regional impacts resulting from the proposed exemption." How is this possible when 92% of the nations imported residual oil, [2] which is the most expensive, is consumed in Petroleum Administration for Defense District I (PAD I)? We are at a loss to understand how you arrived at your conclusion especially in view of the overall price of energy resources on the East Coast which is in PAD I. The prices for residual fuel oil to resellers are now more than 3¢ per gallon higher on the East Coast than the price for the nation as a whole. The price differential of residual oil, if exempt from the regulations, will no doubt rise to the level of other fuels. Natural gas and electric rates in New York State are nearly twice the national average while coal is half again as expensive.[3]

Your Preliminary Finding (1) is that 80-90% of the East Coast's residual fuel oil demand has traditionally been supplied by Carribean imports. You then state that an unspecified increased percentage of the demand has been satisfied by "domestic refining." We ask how much of an increase? We also ask what is being domestically refined? We all know that the United States is importing more crude oil today than at any time in our past history despite the cut backs imposed by the Canadian government. This crude oil is being domestically refined. But the refining process does not make the product domestic. The phraseology of this finding is most unfortunate. Moreover, we believe it should be pointed out that we are not only importing crude oil from abroad but we are now importing residual oil as well from such additional countries as the Union of Soviet Socialist Republics, Japan and many African nations.

Preliminary Finding (3) is that:

"The residual fuel oil market share of large, integrated refiners has been

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2. Mineral Industry Surveys, "PAD Districts Supply/Demand," U.S. Department of Interior, Bureau of Mines, Table 2, October 10, 1975
3. Federal Regulator Commission, News Release, 11/22/74

decreasing since 1972, while that of the large independent and small refiners has been increasing. However, continued controls could lead to a deterioration of competition, resulting in reduced economic efficiency and higher prices."

Again we are at a loss to understand your reasoning. Does it occur to no one, except to those of us in PAD I who are so vitally affected by your findings, that the reason for the increased market share of the independents has been a result of, and not in spite of, the controls? Is competition not then enhanced by controls? Let us look at what has happened before we make the dire prediction that "continued controls could lead to a deterioration of competition."

The FEA holds out an additional carrot in this finding (3), which is, that the exemption would permit competitive bidding once again. Certainly the State of New York is in favor of competitive bidding. However, we proposed to your Allocations, Regulations and Regulatory Section in Washington in December, 1975, that bidding could be permitted under present regulations. The process of bidding has no intrinsic relevance to the supplier/purchaser relationship. The need for a base year supplier has relevance only to the allocation of supply when that becomes necessary. Bidding can be permitted and at the same time the base year supplier can be kept in place. As stated in our testimony on February 17, 1976 at Region II with reference to the "Reevaluation of the Mandatory Petroleum Allocation and Price Regulations":

> "The entire system of base period supplier could be kept intact without the necessity of involvement with 'surplus' or prohibiting bidding by the simple expedient of requiring the current base year supplier to return to place should the FEA declare a shortage situation. The base year supplier could still be changed on the record by the consent of the base year supplier, the new supplier and FEA. Thus the FEA and the respective States would at all times know who has the supply responsibility in the event of an emergency. Moreover, no supplier should be permitted to withdraw from any area unless he files with the Federal Energy Administration a memorandum within 90 days prior to the withdrawal date, specifying

the following: 1. Documented reasons for withdrawal; 2. a list of his present accounts; and 3. certification of the new supplier which agrees (in writing) to meet the annual requirements of each account. In the event no supplier is willing to accept an account then the FEA should assign a supplier in a manner similar to the assigned risk auto insurance pools."

If the prohibitions against bidding are eliminated what will be left of the allocation and price regulation program? What will remain is the reporting programs, the state set aside, the price regulations and the enforcement authority. Since the "pass-throughs" now authorized can be immediately implemented there is no burden because of the price regulations. This will particularly protect the independants. Therefore, the price competition that aids the consumer will continue.

We must not let a production over-supply lull us into any false security. We need controls to conserve; we need controls to give us time to develop our other energy sources; we need controls to make substitutions for natural gas users who will have to go to alternate fuels; we need controls to convince the American public that we mean business, that we are sincere in our conservation goals.

Finally we turn to Preliminary Finding (2). It is the most succinctly stated. It is the one about which we must implore you to use all of your good offices with Congress to prevail upon it to devise an "inclusive program for energy pricing" as suggested in the New York Times editorial entitled "Gas Fiasco" on February 9, 1976. Finding (2) states:

"Exemption of residual fuel oil from the Mandatory Petroleum Allocation and Price Regulations would not have an adverse impact on the supply of any other oil or refined product subject to the Act." (Italics supplied)

The last four words are the problem. They are: "subject to the Act." There must be some kind of reasonable relationship between price and the BTU content of a product so that no section of the country is preferred over any other section.

As we suggested in our written testimony of March 2, 1976 (a copy of which is annexed hereto and made a part hereof) in which we opposed both proposals with reference to the entitlement program:

> "We must strongly urge that the FEA 'go back to the drawing board', schedule another hearing with sufficient notice to enable the States and other interested parties to be able to maximize their input. It might be wise, though unusual, in connection with a program of such complexity to suggest to interested parties that they submit their own plans then circulate these plans among those who have expressed their interest by requesting the plans or submitting a plan of their own and thereafter holding a hearing as to which of the plans is not only workable, but will accomplish the purpose desired."

The position of the State of New York, as set forth in written and oral testimony at various times, as well as at the "think tank" session on contingency plans held on February 5, 1976, at Region II, is that all energy resources must be taken into account. Energy planning cannot be done "piecemeal". If specific additional authority is needed by the FEA to do the job then it is FEA's responsibility to seek that authority from Congress. A contingency plan geared to a scenario of a prolonged oil embargo which, for instance, calls for a four day week cannot be implemented by just requiring the schools, hospitals, industries, etc., heating with oil to go on four days. It must speak to all energy resources. Every fuel is a potential alternate for every other fuel.

If we are going to achieve conservation then we must stop this piecemeal approach.

We reiterate our testimony given on February 17, 1976 at Region II:

"Congress has just passed and the President has just signed the bill about which we meet today. It calls for mandatory energy efficiency in automobiles and appliances, $150,000,000 for State Energy Conservation Plans, $750,000,000 to develop coal mines, materials allocation (even to the rail hopper cars and the over-the-road fleet trucks) contingency plans, rationing. Why? Is all this only because there may be another embargo? We also know that the earth will run out of oil and natural gas and, yes, eventually, even coal. The Canadians know

this and are curtailing their exports to us." "The (Canadian) National Energy Board is being 'very strict' with its export licenses, say one exporter which had its request for No. 6 oil cut in half out of Ontario. At least one major was recently cut back on its requested export volume of the same product out of Sarnia."[4] The anticipated shortage of natural gas was alleviated by a late winter this year. The economic revival we all at least pray for will require energy."

"We have a mechanism in place which can be used to conserve. We have the ball!! Let's not bat it, kick it, club it or throw it away. If it is not the best shape for the game of survival that we are playing, then let us reshape it to our needs."

Instead of exempting residual oils or any other product from the Mandatory Petroleum Allocation and Price Regulations we should reshape the regulations to make it more workable and make it more in tune with our primary goal of conservation.

The intent of Congress with reference to conservation is clear. If in hammering out a compromise the authority delegated to the Federal Energy Administration over all energy resources for the purposes of conserving them was insufficient, then we beg you tell Congress; ask Congress for what you need! Your responsibility to our country in this time of impending disaster calls for nothing less.

Allocation is a tool for conservation!!

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[4]Platts Oilgram, February 12, 1976, p. 3A

STATEMENT OF PACIFIC GAS AND ELECTRIC COMPANY
BEFORE THE
SUBCOMMITTEE ON ENERGY AND POWER
INTERSTATE AND FOREIGN COMMERCE COMMITTEE
HOUSE OF REPRESENTATIVES
APRIL 6, 1976

Exemption of Residual Fuel Oil from the Federal Energy Administration Allocation and Price Regulations

My name is Ralph B. Dewey. I am Assistant to the Chairman of the Board of Pacific Gas and Electric Company, one of the two largest electric and gas utilities in the United States, serving most of northern and central California, a territory with a population of approximately 8,673,000.

I appreciate the opportunity to appear at this Hearing and present PGandE's views on the subject of residual fuel oil decontrol.

PGandE believes that exempting residual fuel oil from price regulation, while retaining controls on other products will inevitably result in further disproportionate increases in residual fuel oil prices. PGandE urges that price controls be retained on residual fuel oil until such time as price controls on all other products are removed.

By way of background, approximately 70 percent of PGandE's installed electric generating capacity consists of gas and oil-fueled thermal-electric generating plants. For a variety of reasons, including the declining deliverability of natural gas and delays in the completion of nuclear plants, PGandE has become increasingly dependent on low sulfur residual fuel oil for use in its thermal-electric plants. PGandE's fuel oil requirements have increased from approximately 2.5 million barrels in 1972 to approximately 11 million barrels in 1975 and an estimated 34 million barrels in 1976.

As both a major domestic purchaser and a direct importer of residual fuel oil, PGandE has regularly participated in FEA proceedings involving fuel oil allocation, price and import regulations. Yet the media and some governmental officials continue to suggest that only electric utilities in the Northeastern portion of the country are concerned about residual fuel oil prices. On the contrary, one of the main points which I hope to make today is that PGandE and other West Coast utilities are also dependant upon imported oil and are vitally concerned with governmental policies affecting its availability and price.

In the context of various FEA rulemaking proceedings, PGandE has pointed out that electric utilities and their customers have borne a burden of increased fuel costs which have been disproportionate to both increases in other fuel costs and to the ability of electricity users to reduce demand. We recommended the restructuring of the cost pass-through regulations so that products, such as residual fuel oil, whose elasticity of demand is lowest, would absorb relatively less increased costs than such price-sensitive products as gasoline.

On March 13, 1975, the FEA announced proposed regulations addressed to the concerns that PGandE and other utilities had expressed. In its Notice the FEA stated:

> "FEA believes that the allocation of a greater than proportionate share of increased petroleum costs to gasoline prices would enhance the effectiveness of the President's energy conservation program and is consistent with the Congressional objectives underlying the Emergency Petroleum Allocation Act.
>
> "In addition, we are proposing further direct restraints on the pass-through of increased costs to residual fuel oil in response to comments concerning the hardship to electric utilities and their customers caused by disproportionately high increases in residual fuel oil prices."

Obviously, the so-called "tilt of the barrel" regulations, proposed by the FEA's Notice of March 13, 1975, have never been adopted, and residual fuel oil prices have remained disproportionately high.

Moreover, throughout this period residual fuel oil prices have been consistently higher on the Pacific coast than on the Atlantic coast. According to the most recent report of the Federal Power Commission, the average price of 0.31 percent and 0.5 percent sulfur fuel oil delivered to steam-electric generating plants during November, 1975, was $15.66 in the Pacific region, as compared to $11.72 in New England and $12.35 in the Middle Atlantic Region.

In short, even under price control residual oil has borne a disproportionately greater portion of the cost of a "barrel" and West Coast utilities have been saddled with higher prices for residual oil than other parts of the country. This unfair burden on our electric customers should not be aggravated by inviting price increases through price decontrol of residual oil while retaining it on other products.

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DECONTROL OF RESIDUAL FUEL OIL AND ASSOCIATED ENTITLEMENTS PROGRAM CHANGES

Lawrence Kumins
Analyst in Energy Economics
Economics Division

April 5, 1976

FOREWORD

On March 29, 1976, the Federal Energy Administration (FEA) formally notified Congress of its intention to decontrol residual fuel oils selling price, as well as to make substantial changes in the crude oil entitlements program. Under the Energy Policy and Conservation Act (EPCA), these changes will become effective within 15 days unless overridden by either the House or Senate.

In response to numerous requests from both Members and Committee Staffs, we have analyzed the market dynamics stemming from these changes. Any prediction of market behavior is frought with pitfalls, and analyses such as these contain many uncertainties.

DECONTROL OF RESIDUAL FUEL OIL AND ASSOCIATED ENTITLEMENTS PROGRAM CHANGES

1.0 Introduction

The FEA has proposed simultaneous decontrol of residual fuel oil prices and a fairly complicated change in the already complex entitlement program. The entitlement change is specifically aimed at East the Coast residual fuel market, wherein the Amerada Hess Corp. and some other U.S.-based refiners have played a dominant price leadership role by consistently underselling nearly all competition.

It has been alleged that Hess derived untoward benefits from entitlements, which gave it the advantage of being able to underprice competitors by up to 5 cents per gallon in the Mid-Atlantic market. Indeed, Hess has received over $300 million of cash transfers since entitlement inception, mostly from major oil companies. The press has recently given this situation wide spread publicity, focusing on the Hess situation inequities. Hess' advantage--if it ever really existed--is addressed by the entitlement changes, which effectively removes about 50% of Hess' entitlement income and gives many of its competitors, as well as those users who are direct residual importors on their own, a 30% effective subsidy relative to their present resid acquisition cost.

2.0 Explanation of the Entitlements Program and the Recent Changes

The entitlement program has generated a great deal of controversy, and is universally disliked by major oil companies who have had to disburse the bulk of the program funding. Nevertheless, it is a device

provided to prevent serious inequities from developing given the statutory multitiered crude pricing system.

2.1. What is An Entitlement?

Because current law makes a pricing distinction between "old" oil and uncontrolled and imported crude, those refiners owning old crude production or locked into sources of old crude would have a decisive marketing advantage: $5.25/bbl raw materials vs. others paying more than twice the controlled old oil rate. In order to prevent those having fortunate access to old oil from earning windfalls to the relative disadvantage of less fortunate refiners with high proportions of imported/uncontrolled crude inputs, it was decided, that the benefits of price controls on old oil would be shared more or less equally among all refiners. Rather than mandate a physical exchange of crude, a less cumbersome exchange of money was arranged. Hence the entitlements program.

When a refiner's crude mix contains more than the national average (total old crude divided by imported plus uncontrolled domestic crude) percentage of old crude, that refiner must "buy" entitlements from FEA (which functions as an intermediary) such that his average total crude costs approach the national average. Refiners with "new"/ imported crude ratios above the national average "sell" entitlements to FEA, thereby deriving revenues to offset their high crude costs from that "sale."

2.2 Calculating Entitlement Value

The FEA has not yet issued entitlements for a month wherein the $11.28 new oil price price ceiling was effective. Let us make such a computation so that we can evaluate the recent proposals dollar effect. These assumptions, which dovetail closely with recent history are:

Crude Type	Price	1976 Average Quantity (mbd)	% of Total
Imported	$13.00	4.7	36.4
New	11.28	3.3	25.6
Old	5.25	4.9	38.0
			100.0

An entitlement's value will be based on the price differential between the weighted average new/import price and old oil. This works out to $12.31 minus $5.25 or $7.06.

This is the amount that a refiner having more than 38% old crude will have to pay the entitlements program for each barrel of old over that level. The program attempts to equalize crude costs among refiners. To do this, refiners with old crude in excess of the national average in essence swap that crude with less fortunate refiners whose crude mix includes a share of old below the national average, so that all refiners, in theory, have the same percentage, cost-wise, of old crude in their mix. Since the crude itself cannot easily be physically transferred from refiner to refiner, the refiners exchange money via the entitlements program. Consider this highly simplified example, wherein there are only two refiners in the country. Each has 500 bbls

capacity, for a total national capacity of 1000 bbls. There are a total of 380 bbls of old oil, and 620 bbls of new/imported composite priced at $12.31/bbl. Assume refiners A and B have these crude costs and this mix:

Refiner A		Refiner B	
Old - 300 bbls @ $5.25 =	$1575	80 @ 5.25 =	$420
New - 200 bbls @ $12.31 =	$2462	420 @ 12.31 =	5170
Total Crude Cost	$4037		$5590

Thus refiner A has a total crude cost here of $1553 less than B, all due to his larger old oil share. If both A and B were to have equal old oil shares (190 bbls each), crude cost would be equalized. Rather than having A give B 110 bbls (110 + 80 = 190), A buys 110 entitlements from B, giving him $7.06 per bbl. Thus A's crude costs are raised by 110 x $7.06 = $777, and B's cost lowered by that amount. Now they both have total crude costs of $4,814. A's are $4,037 + $777 = $4,814 and B's are $5,590 $777 = $4,813 ($1 prior due to rounding). This means A must raise his product prices by $777 ÷ 500 bbls or $1.55/bbl. and B will lower his by a like sum if entitlements are to be flowed through to end users.

On a nationwide basis, we can compute entitlement benefits as

$$\frac{\$7.06 \times 4.9 \text{ million bbls}}{4.9 + 4.7 + 3.3 \text{ million bbls}} \quad \text{or } \$2.68 \text{ per bbl.}$$

This means that holders of new/imported blend should find their crude costs lowered by $2.68/bbl on average during 1976 for every bbl of new/imported over the national average. Refiners having 100% new/imported will find all crudes effective acquisition cost lowered by $2.68.

Interestingly, this \$2.68 figure lowers the new/imported price of \$12.31 to the nationwide all over composite of \$9.62 (for new, old and imported). In other words, \$12.31 - 9.62 = \$2.69 and \$12.31 - \$2.68 = \$9.63, with allowance for 1 cent due to rounding.

2.3 The Entitlement Changes

Under the new plan, residual fuel imports (from anywhere else, including other districts in the U.S.) into Bureau of Mines District number one (a minor geographic change from PAD 1 used in previous regulations) will be given .3 of an entitlement, worth 80 cents to 90 cents per barrel. This benefit will accrue to importers of record, which can be any entity, refiner/marketer, terminal operation, electric utility or anyone else. Simultaneously, refiners selling resid in district one will lose .5 entitlements for each barrel, in excess of 5,000 b/d sold in Dist. 1.

2.3.1 Implications of Entitlement Change

Because most of PAD 1's resid is imported into the district as a refined product, the change immediately gives product importers an effective 80-90 cents per bbl (roughly 2 cents per gallon) reduction in acquisition cost (from today's levels) which may or may not be passed along to end users. Table 1 below, reproduced from the FEA's Findings and Views Concerning Mandatory Petroleum Allocation and Price Regulations, demonstrates PAD 1 dependency on (refined) residual fuel imports. Only 23 percent of 1975 consumption was refined in continental U.S. Continental is an important distinction, because another 19 percent is refined in the U.S. Virgin Islands by the Amerada Hess Corp. At present, Hess has an advantage over refined product importers of roughly \$3.00 per bbl.

TABLE 1

SUPPLIES OF RESID TO PAD I (MB/D)

	1972	1973	1974	1975*
Caribbean Imports	1345	1364	1226	920
Virgin Islands	250	215	267	262
Other Caribbean	1095	1149	959	658
Other Imports	253	277	148	144
PAD I Production	103	143	154	188
From Other PAD's	83	48	99	140
Total	1784	1832	1627	1392

NOTE: "Caribbean" includes all central and South American countries bordering the Caribbean Sea excepting Mexico.

* January - October 1975

Source: Bureau of Mines

due to the entitlements program. Hess gets an entitlement worth about $3.00, while refined residual fuel importers don't. They pay, at least in theory, a world market price which embodies the price of OPEC crude without any entitlement benefit. Similarly, those marketing U.S. refined resid are, to some extent, beneficiaries of the entitlements program and have an advantage, at the moment, of up to $3.00 over product importers.

Under the new program, refined product importers will be hypothetically able to lower pices 80-90 cents bbl from current levels, and Hess (and to a certain extent other U.S. refiners would) would raise theirs roughly $1.50 (.5 x $3.00). Even with this trend toward domestic refined resid's convergence on the import price Hess et al. could still have a theoretical 50-60 cents/bbl advantage.

A further possibility is that continental U.S. refiners may choose to sell resid in excess of the 5,000 b/d exemption elsewhere than BuMines Dist. 1., thus limiting supply therein and supporting higher (uncontrolled) prices.

2.3.2 The Hess Problem

FEA describes its entitlements program amendments, to use FEA's language, as being made to adjust the program to the East Coast residual markets peculiarities, or to adjust East Coast market anomalies detrimental to some marketers. What is really meant here is that Hess et al. is underselling other mid-Atlantic residual marketers by several cents per gallon. While this is usually blamed on Hess' entitlements advantage,

actual facts are probably submerged by oversimplification. Further, until a few months ago, Hess' entitlement advantage was limited by the President's crude import duty surcharge.

This $2 per barrel import levy applied to all crude oil, as distinguished from refined products, reduced Hess advantage vs. residual importers whom the tax did not affect. If entitlements during this period were worth $3 - $4 per bbl., Hess' net relative (to product importers) advantage was reduced to the $1 to $2 per bbl. range by the import duty surcharge.

3.0 End of Mandatory Allocation

FEA has proposed, along with an end to price controls, termination of the mandatory allocation program, which performed the allocation function needed during the embargo period's shortage. Essentially, this program "married" those who purchased fuels during 1972 to those who supplied them, in terms of quantity and supplier relationship. This marriage, now that the emergency situation has ended, impedes competition by prohibiting many buyers from shopping around for the best deal. At present, while protecting a few purchasers from a possibility of being frozen out, it is in practice impeding competiton and might well be reconsidered. However, some protection could be offered purchasers who might be abandoned by sole source suppliers by a modification placing mandatory allocation on a buyer preference basis, wherein

the marriage of buyers and sellers could continue if buyers wish it to.

4.0 Residual Price Controls

Under the EPAA, price controls are imposed on petroleum fuels at two levels. The first level of control effects domestically produced crude oil. A second layer of controls covers the process by which crude oil reaches the consumer as usable fuel, passing through the refining and marketing process. The incremental (relative to crude input) refining and marketing costs of oil fuels are thus controlled. Ceiling prices for this increment, as well as the proportion of crude costs allocable to each product, were set in 1974. For some reason, FEA increased residual prices by a substantially greater percentage than other fuels. For example, between 1972 and 1975, residual wholesale prices went up 290 percent, while gasoline increased by 238 percent. In fact, U.S. refined residual costs as much as foreign material, even though it is produced from crude with a blend price of $9.62/bbl., compared to that refined abroad, where crude costs are $13.00/bbl. It is hard to explain why FEA changed the historic relationship between residual's market price and its crude acquisition cost for U.S. refined product, which comprised 51 percent of domestic consumption.

4.1 Residual Pricing

There are a number of manners in which heavy fuels are priced under today's regulations. One is the manner described above, wherein crude costs are known quantity. The remaining 49 percent of U.S.

crude consumption, and 58 percent of the East Coast's, come from sources where crude costs are not identifiable. Here, a seller's acquisition price need not bear any relationship to product manufacturing cost, and in many cases FEA is dependent upon the acquiring marketer's good will in reporting an accurat e acquisition cost. Two of these transactions are discussed here.

4.1.1 Intra-Company Transfers

Much residual imported is refined from crude produced and refined by the various subdivisions of the same international firm, and it is marketed by the U.S. marketing division of that firm, which is typically a major integrated oil company. This residual may be sold for virgually whatever the firm in question claims it cost, plus U.S. marketing expense. With both crude production and refining costs outside the country and FEA's purview, the integrated firm may transfer residual to its U.S. subsidiary at whatever price is most beneficial, given the companies' worldwide activities.

4.1.2 Bulk Cargo Purchase

Resid is also imported by terminal operators who purchase bulk cargos on foreign markets. These transactions frequently involve foreign refining divisions of companies domeciled or doing substantial business in this country, but are again outside FEA's purview. Bulk cargo purchasers resell their fuel subject to a ceiling price composed of reputed acquisition cost and FEA ratified mark up.

5.0 Ceiling Prices and the Criteria for Decontrol

As described, the FEA set ceiling prices for domestically refined residual in 1974, during the Embargo. Since that time, residual has almost always sold for less than its ceiling price. While it is nearly impossible for governmental price fixing to choose exactly the "right" price, it would appear FEA choose a price that was too high, and did not clear the market given a lower world market price. With foreign residuals, much higher crude cost in mind, an incongrous situation has developed in which U.S. residual, with a relative low raw material blend cost, has a higher ceiling price than foreign refined residual that surely embodies more expensive OPEC crude. FEA's proposed remedy for this anomaly is disposal of ceiling prices, since they are largely irrelevant because world market prices are below FEA's domestic ceilings.

This situation does not only apply to residual but to other products as well. While other domestically refined fuels embody blended crude costs which are 25 percent below those of foreign refiners, FEA mandated product ceiling prices nearly equal and sometimes exceed foreign refiners' selling prices. While administering controls at the crude level with apparent diligence, FEA has permitted ceiling prices which would appear to reward the refining and marketing levels with very high markups, seemingly well in excess of European refiner/marketers.

A real danger that price controls as envisioned in EPAA and EPCA can be subverted exists here. Because most U.S. crude is produced, refined and marketed by the same (i.e. producing) firm, much crude has essentially only one point of sale price--that paid an integrated oil company for a refined oil fuel by a consumer. Here the crude price is not 100 percent meaningful, because a consumer buys the fuel which may have several levels of not-well-regulated markup added to it, such that final selling prices are very much higher than crude raw material cost.

6.0 Market Dynamics Before the Proposed Changes

The post-Embargo market for resid in PAD 1 is characterized by several categories of participants. They are:

a) Hess--a maverick independent operating in the U.S. Virgin Islands. Hess enjoys several advantages stemming from an extremely efficient refinery, Jones Act exemption, apparent low cost crude sources, as well as entitlements.

b) Majors operating in the Carribean--these refineries are not eligible for entitlements. They largely acquire crude from other divisions of their companies at prices which are not determinable.

c) Spot purchases--various organizations import bulk cargos of foreign resid.

d) U.S. resid production--resid refined in the U.S. comprises 24 percent of this market. Its price benefits from entitlement eligibility.

Two groups of participants have entitlement benefits--Hess and other U.S. refiner marketers. Together, they comprise 42 percent of the PAD 1 market. Here, they can clearly undersell spot cargo purchases, and they may have an advantage over other Caribbean refiners, although it is hard to say because their crude costs are unknown to us.

Heretofore, the presence of Hess, and probably the action of other refiners as well, in PAD 1's resid markets tended to hold prices below FEA's ceilings. The mandatory allocation program enabled sellers of higher priced resid to market their product to captive, locked in customers of 1972 vintage. Other purchases benefited from the Hess-U.S. refiner presence even though they may have actually purchased from other refiner/ marketers and terminal operators because Hess et al. tended to depress prices of much resid not subject to allocation. Resid users throughout the region benefited.

6.1 Market Dynamics Under the Proposals

Because of partial entitlement benefit loss, Hess et al. will become less effective price cutters. Their prices will increase relative to present levels (by $1.50/bbl.) as will those of the other (non-U.S.) Caribbean marketers who have had to meet Hess et al.'s prices. These firms (mostly major oil companies) have a 47 percent market share. Other U.S. refiners, particularly those outside Bu Mines Dist 1, may tend to leave this market rather than lose the .5 entitlement. Non PAD 1 refiners have 10 percent market share and they might leave

completely because they would lose the economies of bulk transport rates on the 5,000 b/d permitted without penalty. Their departure could put supply pressure on the East Coast market. If this were to happen, the othersmarketing here could take this opportunity to raise prices. With this artificial shortage, Hess and the remaining refiners could find their roles as price leaders/cutters reversed, and it could be to their advantage to price under the (higher priced) Caribbean refiners' umbrella, thus raising prices for everyone.

6.2 Possible Outcome

It is extremely hard to predict exactly what will happen if both proposals are implemented. It is likely that prices will rise by year end, but the magnitude of any possible increase is nearly impossible to estimate. And there is a chance that prices will remain stable, or even decline for the short run. In fact, this is likely, due to the seasonality of resid demand depicted in Figure 1 below.

One factor should be kept in mind, however. This is that even small price changes add to large sums here due to substantial resid consumption in the region. A 1 cent/gal. increase represents about $250 million for PAD 1 at yearly rates given present consumption. Nationwide this figure is estimated in the $380 million range.

Fig. 1 Residual Fuel Sale, 1973-1975